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TO ASSESS THE IMPACT OF TAKEOVERS ON SMALL BUSINESS OPPORTUNITIES

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

TO ASSESS THE IMPACT OF TAKEOVERS ON SMALL BUSINESS OPPORTUNITIES

JUNE 27, 1989

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June 27, 1989:
Morning session 1

TO ASSESS THE IMPACT OF TAKEOVERS ON SMALL BUSINESS OPPORTUNITIES

TUESDAY, JUNE 27, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
St. Paul, MN.

The Committee met, pursuant to notice, at 10:15 a.m., at Hamline University School of Law, Moot Courtroom, Hon. Rudy Boschwitz (Acting Chairman) presiding.

STATEMENT OF HON. RUDY BOSCHWITZ, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator BOSCHWITZ. We'll begin.

Takeover legislation and this whole business of corporate takeovers creates a great deal of attention, except for this morning, apparently. I'm very disgusted that—I presume that we tried, at least, to get some publicity about this hearing, and it's interesting to note that——

Mr. JACOBS. I think I was your problem.

Senator BOSCHWITZ. I didn't want to say that, Irwin.

I have a regular prepared statement, but the real question is, should assets of a company be used as collateral for a loan to take over that company. There have been takeovers of various types over the years and in my lifetime, starting really with Harold Jenine when he conglomerated and then a lot of people have made a business of unconglomerating those that have been conglomerated. But much of this has been taken out of context because far and away the largest number of takeovers are done in a very friendly manner and are beneficial, I believe, to all concerned; stockholders, employees, companies, and themselves. It's interesting to note that the 1987 stock crash of October took place very soon after the Ways and Means Committee in the House and the Senate and began to consider means of restricting takeovers, which certainly would have lowered corporate values. The result is that some people have come to the conclusion, and I'm sure that there are other reasons, particularly if you look at other things like the stock market crash. Some people also attribute some of the problems to that.

I'm trying to summarize quickly since this vast crowd here—what happened? You're supposed to turn out a crowd, it must be the staff's fault.

People who work for companies always have some fears. Sometimes those fears are justified, most often they're not. Most often

companies that are taking over become more aggressive. But people do have fears and I suppose that's to be expected. I know that some people have talked to me as I travel on Northwest Airlines, even stewerdesses. They're concerned and I try to reassure them. The airline industry, in recent years, has been turbulent, so they have some doubts.

Many Minnesotans have written to me about Federal legislation to restrict takeovers. Interestingly, the Majority Leader, Senator Mitchell, shortly after he became the Majority Leader of the Senate, said that he felt, and I agreed with this assessment, that we very often in Washington do things without knowing the impact of our own deeds. He said that this would very likely be the same, that we would pass legislation and not realize and not know the impact. He said it might be quite harmful to the economy, so he was not in favor of legislation, most of which has centered around the deductibility and funding of such takeovers. I have not been in favor of that, either.

I think also that the number of takeovers, the hostile takeovers, is sometimes exaggerated. In this year I noted that in the first quarter of 1989 only $3.4 billion in deals has been announced. That is in the first quarter and I suppose now in the second quarter it will be more than that, simply because of Northwest. But in normal 1988 a total of $36.8 billion was announced in deals and that included the PESCO deal. So Pillsbury accounted for the majority of these larger buyouts that occurred in 1988.

There are many cases where takeovers improve the condition of the company. Takeovers improve research, improve efficiency, and so forth. In some types of cases, however, investors put stock into play solely for the purpose of reaping the profit, with no intention of following through, and Greenmail sometimes occurs.

I would be interested if we can find a reasonable way of finding an answer to preventing stock from just being put into play. There are many questions that arise.

I'm summarizing my opening statement, but I think that we will just proceed from my perspective and summary that there is really no clear evidence pointing that an appropriate legislative solution is necessary at this time. But we'll see what the witnesses have to say and I certainly will keep my mind open.

[The prepared statement of Senator Boschwitz follows:]

STATEMENT OF SENATOR RUDY BOSCHWITZ
SMALL BUSINESS COMMITTEE HEARING ON TAKEOVERS
JUNE 27, 1989

I WOULD LIKE TO WELCOME ALL OF YOU TO THIS HEARING REGARDING CORPORATE TAKEOVERS.

TAKEOVERS RECENTLY HAVE BEEN ATTRACTING PUBLIC ATTENTION, ALTHOUGH CORPORATE RESTRUCTURING ACTIVITY IS NOT NEW. IN THE POST-WAR PERIOD, WE WITNESSED A FLURRY OF SO-CALLED CONGLOMERATE MERGERS AND ACQUISITIONS IN THE LATE 1960s AND EARLY 1970s. UNDERSTANDABLY, THE CURRENT FOCUS HAS BEEN ON THE RECENT LARGE SO-CALLED HOSTILE TRANSACTIONS.

BUT THE VAST MAJORITY OF SUCH TRANSACTIONS ARE FRIENDLY AND MOST EVERYONE CAN AGREE ARE BENEFICIAL FOR THE AFFECTED COMPANIES, THEIR EMPLOYEES AND SHAREHOLDERS. AND YET, PROPOSALS BEING CIRCULATED TO RESTRICT TAKEOVERS WOULD AFFECT ALL SUCH TRANSACTIONS EQUALLY. MOST PEOPLE AGREE THAT ONE REASON THE STOCK MARKET PLUMMETED IN OCTOBER 1987 WAS BECAUSE OF PROPOSALS BEING CONSIDERED IN THE HOUSE WAYS & MEANS COMMITTEE TO MAKE TAKEOVERS MORE DIFFICULT WOULD HAVE LOWERED CORPORATE VALUES.

PEOPLE WHO WORK FOR COMPANIES ALWAYS HAVE FEARS. THESE FEARS NO DOUBT WILL INCREASE BECAUSE OF THE RECENT ANNOUNCEMENT THAT NORTHWEST AIRLINES HAS AGREED TO BE TAKEN OVER BY A GROUP HEADED BY ALFRED CHECCI.

MANY MINNESOTANS HAVE WRITTEN TO ASK ME ABOUT POSSIBLE FEDERAL LEGISLATION TO RESTRICT TAKEOVERS. IT APPEARS TO ME THAT THERE ARE NOT ONLY GOOD BUT BAD ASPECTS OF TAKEOVERS. FIRST, CONSIDER THAT THE VAST MAJORITY OF TAKEOVERS ARE FRIENDLY. IN 1986, ACCORDING TO W.T. GRIMM & CO., ONLY 40 HOSTILE TAKEOVERS -- A RECORD -- WERE ATTEMPTED; OF THESE ONLY 15 SUCCEEDED. INDEED, SOME SAY THE CURRENT CYCLE OF TAKEOVERS MAY HAVE PEAKED. ACCORDING TO BUSINESS WEEK MAGAZINE, THE TOTAL VALUE OF LBOs COMPLETED IN 1988 WAS $36.8 BILLION, OF WHICH THE RJR NABISCO DEAL ACCOUNTED FOR $29.6 BILLION. IN THE FIRST QUARTER OF 1989, ONLY $3.4 BILLION IN DEALS HAD BEEN ANNOUNCED.

IN MANY CASES, TAKEOVERS IMPROVE A COMPANY'S EFFICIENCY, STREAMLINE TOP-HEAVY MANAGEMENT AND PUT COMPANY RESOURCES TO MORE PRODUCTIVE USE. BETWEEN 1979 AND 1986, CORPORATE-FINANCED RESEARCH AND DEVELOPMENT ROSE 51 PERCENT, AFTER INFLATION. THE INCREASE BETWEEN 1979 AND 1986, WHEN TAKEOVERS WERE NOT UTILIZED, WAS ONLY 12 PERCENT.

STOCKHOLDERS ALSO SEEM TO DO PRETTY WELL WHEN A TAKEOVER SERVES TO BRING THE PRICE OF A STOCK UP TO ITS TRUE VALUE. EVIDENCE I

HAVE SEEN INDICATES THAT, ON AVERAGE, INVESTORS GET 25 TO 40 PERCENT MORE THAN THE PREVIOUS MARKET PRICE. THIS EXAMPLE WAS DRAMATICALLY DEMONSTRATED IN THE CASE OF PILLSBURY AND NORTHWEST, WHERE THE PREMIUM PAID WAS, OR WILL BE, QUITE SIGNIFICANT. IN THE CASE OF NORTHWEST, IF THE DEAL HOLDS UP, INVESTORS WILL RECEIVE A PREMIUM OF APPROXIMATELY 100 PERCENT, BASED ON THE STOCK PRICE IN APRIL THIS YEAR.

IN SOME CASES, HOWEVER, AN INVESTOR MAY PUT A STOCK INTO PLAY SOLELY FOR THE PURPOSE OF REAPING ARBITRAGE PROFITS, WITH NO INTENTION OF FOLLOWING THROUGH. AN EXAMPLE WAS THE ATTEMPT BY THE HAFT FAMILY TO ACQUIRE DAYTON HUDSON CORPORATION. THIS TYPE OF TRANSACTION DOES NOT ADD ECONOMIC VALUE TO THE COMPANY IN PLAY; IN FACT, THE OPPOSITE MAY OCCUR WHEN THE TARGET COMPANY IS FORCED TO INCUR SUBSTANTIAL DEBT TO PAY "GREENMAIL". THIS TYPE OF TRANSACTION SHOULD BE MADE MORE DIFFICULT, OR EVEN STOPPED, IF POSSIBLE. INDEED, I VOTED FOR LEGISLATION TO IMPOSE A 50 PERCENT EXCISE TAX ON ANY GAIN REALIZED IN A "GREENMAIL" TRANSACTION.

EVEN IF WE CAN AGREE THERE IS A PROBLEM (AND FOR COMMUNITIES AND EMPLOYEES ADVERSELY AFFECTED BY A TAKEOVER, THE PROBLEM CAN BE ACUTE), THE REAL DIFFICULTY IS WITH FINDING A SOLUTION THAT CAN BE LEGISLATED SO AS NOT TO PRECLUDE OR MAKE MORE DIFFICULT THOSE TRANSACTIONS THAT HAVE A LEGITIMATE PLACE IN OUR ECONOMY.

FROM MY PERSPECTIVE, THERE ARE SEVERAL ECONOMIC POLICY ISSUES REACHING BEYOND THE SCOPE OF THE SECURITIES LAWS THAT MUST BE CONSIDERED IN THIS DEBATE, INCLUDING THE FOLLOWING:

*TAX POLICY: TO WHAT EXTENT DOES THE EXISTING TAX CODE ENCOURAGE CORPORATE DEBT GENERALLY, AND LEVERAGED BUYOUTS IN PARTICULAR?

*PARTICIPATION OF FEDERALLY INSURED INSTITUTIONS: ARE FEDERALLY INSURED DEPOSIT INSTITUTIONS INVESTING "EXCESSIVELY" IN THE DEBT USED TO FINANCE LEVERAGED BUYOUTS?

*ECONOMIC POLICY: WILL THE DEBT USED TO FINANCE LEVERAGED BUYOUTS AND CORPORATE RESTRUCTURINGS EXACERBATE AN ECONOMIC DOWNTURN?

*CORPORATE PERFORMANCE: WHAT EFFECT DO LEVERAGED BUYOUTS HAVE ON CORPORATE PROFITABILITY, WAGES AND EMPLOYMENT, AND EXPENDITURES ON RESEARCH AND DEVELOPMENT?

FROM MY PERSPECTIVE, THERE IS NO CLEAR EVIDENCE POINTING TO AN APPROPRIATE LEGISLATIVE SOLUTION TO THIS COMPLICATED ISSUE. I WOULD INVITE THE WITNESSES TO COMMENT ON THESE ISSUES DURING THE COURSE OF TESTIMONY.

AGAIN, I APPRECIATE THE WILLINGNESS OF THE ASSEMBLED WITNESSES TO APPEAR BEFORE THIS COMMITTEE. I LOOK FORWARD TO YOUR TESTIMONY.

Senator BOSCHWITZ. We have this morning as witnesses: Mr. Irwin Jacobs of Jacobs Management; Professor Paul Reynolds, University of Minnesota, Department of Sociology; John Lindahl with Norwest Growth Fund; and Frederick Weyerhaeuser, who I don't believe has arrived yet; and Dr. Bruce Erickson of the Carlson School of Management. Is he here? All right.

And, Irwin, if you will start.

STATEMENT OF IRWIN JACOBS, JACOBS MANAGEMENT, MINNEAPOLIS, MN

Mr. JACOBS. Rudy, are you going to keep us to 5 minutes, literally?

Senator BOSCHWITZ. No. Senate rules normally say 5 minutes, but we really can operate less formally. Normally the 5-minute rule is set because there are some Senators that take a long time to take questions, so they want to get through the testimony very rapidly. The staff always has, sure enough, a lot of questions that the Senators ask at the staff's instruction, but since we have——

Mr. JACOBS. We're on home turf.

Senator BOSCHWITZ. Home turf, and we only have one Senator. As a matter of fact, it's an opportunity, to get away from that rule.

Please proceed.

Mr. JACOBS. Thank you, Rudy. I appreciate the opportunity to be here.

I have a real serious problem when I am confronted with the idea that takeovers are either all good or all bad and that's what people are looking for, is the answer to creating the so-called perfect solution. I don't believe in life that there is a so-called perfect solution that exists for anything and yet we have to have optimism toward a solution, otherwise, no one would try to make things better.

In looking at takeovers from a small business point of view, which I think is the idea of this hearing, and having to do with both jobs and what is the reaction to communities, citizens, employees, and everybody else, let me tell you that there are some very difficult and tough moments to deal with in making decisions, at times, that are not necessarily favorable to all, but you've got to realize that any decision that is made is really made—believe this or not—or whoever wishes to challenge it, I'd be glad to debate them on it, that tough decisions are really made for long term, particularly in situations where you have a takeover that is a shrinking-down process, that a company has become too fat, there is an opportunity to create consolidation in the industry and become competitive.

What I find interesting today is that people really are focusing on, is the macro situation, rather than the micro, from the standpoint of looking at competitiveness throughout the world. We used to have a franchise in our own country from the standpoint of dealing here and trying to compete abroad and what's taken place is that we have become less competitive in our own country and not as competitive abroad.

For the first time, I think surely in my lifetime, I am seeing an atmosphere of competitiveness both domestically and international-

ly to giving business to those who have the ability to be competitive and to have the right marketing plans and to have the right organization, regardless of their size, because small business is not precluded from international trade or from nationwide trade and there's this perception that small business is squashed from the standpoint of being allowed to go out there and compete because big business will take it away.

I think the small business has opportunities that big business does not. They have flexibility, the ability to change and move quicker, less layers of bureaucracy, and being your own situation, Rudy, you can relate to that, starting a business, being there, and making the decisions yourself, you didn't have to go through 12 layers.

From my own personal standpoint, I have found it interesting that in this way we can stay closer to our businesses, but more important, closer to our people, in allowing them to make decisions and we have many small businesses, as well as the large businesses, so I do have the opportunity to look at both sides.

The concern that I have is that there are abuses of the system, there's no question in my mind about that, and yet I'm sure that there are some things that could happen or should happen to stop some of these abuses and yet there's a belief that by stopping takeovers, we'll cure all.

Truly, absolutely, a fallacy, and you know, people do not like change, change is the biggest fear of all. You look at the Northwest Airlines situation here and I almost find it comical, in a tragic way, that here is a State that, I believe, punished the airline for being in existence here with everything they could throw at them. It was more of a love/hate relationship than it was of a great corporate citizen or a great employer of our State. I believe that the communities here really never appreciated the airline and now all of the sudden the airline has been taken over and has become the darling and the biggest threat to our community.

I've had the same experience that you've had flying the airline, and people say, my gosh, we're going to lose our jobs, the stewardesses, captains, the ticket counter people, many of them say buy the airline and save it. I said, "Don't be ridiculous. I can't save this airline. You're the greatest asset this airline has got, is the people that are here." So there's truly a misunderstanding, really, of what is going on.

My hat is off to Northwest Airlines, both board and management, to deal with this thing, as business-wise they could really enhance the free enterprise system and yet I believe that when it came to transportation such as the airline business, I was one of the first to say that I wasn't necessarily in favor of deregulation of the airline business, but that doesn't mean I'm wrong and the system is right or vice-versa, that what I say is necessary to what it should be, but airline business is completely different.

I look at my own situation. For example, if there was takeover restraints today on the system, some of which I have heard proposed, I wouldn't be here today speaking to this, if this took place back when I started, because I started in a small business in Minnesota. In fact, I still make this my base. We've created over 8,000 jobs in this State and it didn't happen because we had a lot of——

Senator BOSCHWITZ. How many?

Mr. JACOBS. Over 8,000 jobs. And it started out we were all small businesses in Little Falls, MN, where at one time we bought a bankrupt boat company in 1977, 1978 and really was a great success story up there. They had 70 people, today we employ 700 people in Little Falls, MN, which is basically the town, almost. New York Mills, MN, same situation, Lund Boat Co., which was basically the town's one boat company. I mean, I think the town's population is less than 1,000 people up there and we employ 300 some of them.

What made all this happen was our ability to consolidate, buy other companies, such as the Wellcraft Boat Co., which was part of a mini-conglomerate down in Southern Florida, Coral Gables, who was a bigger company than we were at the time. And what created our boat business, in a sense of being an international and national player to compete, was the takeover and at that time a hostile takeover. We became a real live threat to the industry from a competitor's point of view when we, in effect, took over that company. And after that became AMF, which was Haverly Boats, and the AMF situation to be very specific, was a situation of one of the most poorly-managed companies I've ever witnessed in my life. Until this day I haven't found one worse, and there's a lot of badly-run companies out there. But it was run for a handful. It was not run for the employees, it was not run for the shareholders, it was not run for the community, it was run for that few and corporate who created dynasties and ivory towers for their own atmosphere.

How do you deal with something like that? Do you create legislation to allow people like this to continue to run their businesses? We did, in fact, buy AMF and we did, in fact, shut down their corporate structure. There was almost 400 people in that corporate structure.

Senator BOSCHWITZ. Was that hostile?

Mr. JACOBS. Very hostile.

Senator BOSCHWITZ. Very hostile.

Mr. JACOBS. Very, very hostile. But in any case, what was important, it was painful to lay those people off because it wasn't 395 people that I felt were responsible for the situation, it was the 5 of the 400 that were there that were creating this atmosphere, complete spoil and waste of the system and being that competitor, and worse than that, they, in effect, were threatening 20,000 jobs of the operating units because of their way of doing business, which was an absolute waste of everything that existed. We purchased AMF and the fact is that we did sell off many of their businesses. We sold them off to management where management wanted to buy and could buy them and that financed management in allowing them to buy new businesses.

I will tell you, as I sit here today, I do not know of one of those businesses that is not better off today, has more jobs than it did at the time AMF ran it and, in fact, if you took the combined operation of all the businesses that we bought in AMF and broke them out as they were sold off piecemeal and the ones that we have kept, that there had been net jobs of almost 20 percent since the time that we took that company over and disbursed certain units of it.

So the painful thing, as we sit here in the State of Minnesota, and we see the Pillsbury, we see the Northwest Airlines and yet it is painful to realize somebody that is 54 years old or 57 years old or misses their cutoff, how do you deal with that? I really don't know and I'm more than happy to look at something like that because it isn't because I don't have a lack of feelings or understanding of people. The only reason I believe I am successful today is because of the staff and the organization that we have out there. So the bottom line to it is that the system surely cures mistakes of success and failure, meaning in the financial and competitive worlds, it does not take care of those—-and I don't want to use the word "those few," because "those few" could mean one person and how do you deal with that individual's family and personal situation, it's not easy to do and I can't sit here and tell you for a minute that I don't have feelings and understanding for that, but the fact is that the system has to go and has to work in a way that it really does take care of itself, the free enterprise system. You know, if we look back 50, 60, 80 years ago, the turn of the century and people were going to say that you can't put automobiles on the street because you're going to put all the wagon builders out of business, you can imagine where we'd be today.

Clearly, as in everything that they've done both in this country and the world, is to make it a better place to live from every standpoint, not just financially, but communities, people, responsibilities, cultures, whatever the case may be. I think that the system is, in fact, trying to do that, I believe, desperately against the fact of the Government creating what they believe to be the perfect solution, and yet I think that the Government has to continue to always be looking and riding the situation from the standpoint of making sure that the abuses are, in fact, dealt with in a way that people who take advantage of that system, that there are ways of dealing with that. Thank you.

Senator BOSCHWITZ. Which way do you think many folks are taking advantage of the system?

Mr. JACOBS. From my point of view, when I see the system, it's where the Government is given an opportunity—to me the greatest abuse of the system is the investment banking community being allowed to create ideas of what things should be, shouldn't be, are, or are not, because the fact is that you need what are so-called iron standards of opinions that shareholders want the responsibility is still with the board of directors and publicly-held companies and the abuse in investment banking today on Wall Street, which is Wall Street, investment banking is Wall Street today, to allow these people to create situations—they're the people who have put the companies in play more than the so-called "raiders," because the fact is they are generating fees of a magnitude that is beyond belief.

If I told you how many calls I get in a month from people who pretend to be my enemy in the open world, but who say if you do such and such, here's the value of what it is and they're trying to generate ideas to us to basically put companies in play. This is a complete and absolute abuse of the system. If this is what people are fighting against, it's being focused on the wrong party. It should be focused on who is doing it. Now, can you stop them from

doing this, no, because they will go off on their own and say to other individuals, I have an idea. I don't know how you deal with this, other than the fact is that we've created a structure in allowing these people to create fees that are so obnoxious, it's beyond belief. For an example, I haven't heard a lot about this, but you talk about the RJR deal. I have no problem with people making fortunes on an idea, I have no problem with that, none. I'm not going to sit here today and tell you that the investment bankers got overpaid. But I don't hear a word about the investment banking community in all of this Government. You know, the people who are lobbying the most in Washington, and you know this, Rudy, are the investment banking people, and you know they don't want this to stop. It's not businesses who are out there really getting it done, there's no security there, it's the people who are, 1, concerned about being taken over, and, 2, by the investment bankers who want them to be taken over.

When you look at the fees of $300 million in a transaction or you look at Marty Lipton's statement who said, "I was entitled to $25 million for 2 weeks of work. Why should an investment banker get it and I shouldn't get it." You know, these people are holier than holy, in the eyes of the world. Marty Lipton, I mean, he writes the Bible of law, in his eyes, and tells you the way the world should work. I have nothing against his abilities for what it is. Do you want to stop all of this and just say we go back to minimum wage and that the system doesn't work because of all these abuses? The fact is that I don't have any answers for you. But where I really feel there is a hypocritical situation here and is not exploited is clearly those areas that are making this happen.

Let me tell you, we can't generate the ideas in our office that come to us every day, there's too many of them. Our backlog of deals that we look at is far more than we'll ever be able to look at. We'll never be able to see all the deals that are brought to us. They're not brought by people walking off the street, they're brought by Wall Street. And I will tell you first hand that there's nobody that in the open world despises me more than the people I'm talking about. I don't have any wars going on with them, personally, but they tend to be the friend of their customer when, in fact, their incentive is to sell that company. You know, if you look at people—I shouldn't get into names here, but if you look at the people who have been behind the Pillsbury transactions on both sides, there are some of them that said we would never do an unfriendly transaction, and the next week, you know, they're the bidder of a hostile takeover. They say it's not because it's a friendly offer, but that's putting your company into play, you understand, they're saying we want to buy friendly. What's the difference? If they said it's not for sale and you say you want to buy, you create a value for that company that shareholders haven't seen and all of a sudden things begin to happen. There are companies that do not deserve to be independent from the standpoint of getting a fair shake, to their shareholders and to their employees, in spite of what some of their own employees believe. And yet for you or I or Congress or the Senate or the Government, we to create the right system for that. It's absolutely absurd. The system does work ultimately. In other words, with all these abuses, the right businesses

do exist, meaning that they can compete, if they are competitive, and they failed and there's too much money, junk bonds, banks, whatever, someone else is going to win that business, it doesn't go away, it doesn't disappear, no different than all the money that goes to takeovers.

People say look out how disasterous it is, for all this money, what good does it do? Well, the fact is if you were a holder or I was a holder, or Joe Thomic of RJR has $25 billion takeout, that money didn't go under mattresses, it went to somebody to re-invest. There's more money in the system today for investment than ever before. And banks will tell you that the demand for money is at an all-time low. If it wasn't for the transactions out there that are taking place, there would be nothing going on because there really is no need for money, if you can't consolidate or expand.

Senator BOSCHWITZ. There is much talk about the fact that many companies are getting highly leveraged and that they're, therefore, great risks and that they're going to fail and I think that only one has thus far failed, a drug company based in Ohio.

Mr. JACOBS. That's REVCO, and you can't—again, Rudy, you said "failed," they have not failed, they——

Senator BOSCHWITZ. They're in bankruptcy.

Mr. JACOBS. Which isn't failure yet.

Senator BOSCHWITZ. Let me continue the question and what I have said and then we'll give you some examples. This is the only example, thus far. Perhaps, some of our witnesses will have other examples. I suggest we'll wait until the recession. During the recession, these people who are highly leveraged at high interest rates, be it 7-Eleven or whomever, are going to have great difficulty. I wonder if I could ask for your reaction on that.

Mr. JACOBS. I have heard about recession for the last 2 years. It's 3 months, 6 months, first of the year, end of the year. I'd really like to know, Rudy, who knows when it's going to be. And for us to sit here and pretend that there's going to be a recession in 90 days, 6 months, or 9 months, you have to watch your businesses, you have to be realistic.

When we talk about leverage in our system today we have to look at the rest of the world because we're competing with the rest of the world.

Let me tell you, we don't know what leverage is in this country next to what it is in other parts of the world, and we're competing against them. The problem that we have got is that we are just having an awakening over the last 2 or 3 years of what is going on, it is forcing people to do things that should have been done years ago. Why should you sit there and pretend—and this is going to be hard to understand for a lot of people—to overcapitalize a situation. You must be in need and want and desire in order to be successful in whatever it is. And to sit there with what I believe an overcapitalized situation is just as bad as to sit there with an undercapitalized because people don't have the urgency and the need and the desire to make the hard decisions that are made. You've got to keep people's feet to the coals at all times to be competitive and understanding. I'll telling you that to sit there and take an example of—whether you want to use the REVCO situation, which don't count out yet, there's a reorganization, but there are a lot of

businesses in trouble in this country. Don't assume because they're an example that surfaced, that they're one of the only ones that's going to be, you're going to see a lot more. But don't blame that just on leverage. There will be some people that will succeed very handsomely, based on the failure of other people. Hey, look, why did we succeed in the boat business? We were never people in the boat business before. We were bad mouthed when we went after AMF. They said, these people aren't boat dealers, they run a little company in Little Falls, MN, what right does he have to come in and take over our big, successful company? Well, in 1984 when we bought Wellcraft we did $53 million worth of business, we did $300 billion last year.

Senator BOSCHWITZ. A million.

Mr. JACOBS. And that's in 5 years. Haverly we bought in 1985 for $80 million, we'll do $180 billion this year. And very successful and more important, and more factories and in a business that— there is no business that's more competitive than the pleasure-boating business. There are 1,500 manufacturers, there is no monopolies in the business. We are the largest independent in the world with a 15 percent market share, that's the largest independent in the world. And we leveraged, by your term what "leveraged" means. He can attest to it, he's my banker.

Senator BOSCHWITZ. Tell me, you talked about the competitiveness of the United States, what you think to be the whole movement of takeovers, the whole movement of leverage buyouts, and so forth, that is, in your judgment, increased to improve the competitiveness of the country?

Mr. JACOBS. Let me answer that two ways. First of all, I am 47 years old and I will tell you, ever since I remember being in business, I have never seen a better time of competitiveness for our products in this country, both the quality, timing, efficiencies, both here and abroad, as I do today. I have never seen people so aware of what they are doing today versus what they were doing 10 years ago. To use the term as "takeovers is the only reason for this," no, I don't believe this, but it is a factor and there is an awareness at companies today that believe they're bullet proof, that no one can ever take them over.

The fact is that everybody has a sense of vulnerability to create what is so-called value and understanding of who they work for and what the responsibilities are. So just to make the statement, "is takeovers responsible," no, there is an awareness and an awakening to it, but in order to compete internationally, which has become a real problem for this country, our dollar has been very helpful with that, obviously, and to me that's the biggest threat of breaking down that system of international competition, would be for the dollar to rise such as we saw here a couple of weeks ago. I'm very happy to see it stay down and be competitive.

It's all these factors, Rudy, it's not just one.

Senator BOSCHWITZ. There is a sense of vulnerability and I have thought that sense of vulnerability, as you have said in your earlier testimony, kept people's feet to the coals, so to speak. I understand that this is not the only element of raising productivity numbers, but I believe— at least that's one. There is a feeling of helplessness from the people in the airlines that you have talked to; the

stewardesses, the ticket counter, the pilots. There's a sense of helplessness and I'm not quite sure what to do or how to address that, either. I have found, at least in my business experience, that the only way to deal with that sense of helplessness is for you or for me or Fred Weyerhaeuser to have a relationship with his employees, or our employees, but——

Mr. JACOBS. There's a very important piece to what you just said. The helplessness that people refer to——

Senator BOSCHWITZ. There's a sense of—even the guy behind the counter.

Mr. JACOBS. OK. I totally agree with that. But let me tell you what the cure is, the personal cure for such a thing is. There's a personal pride in understanding what an individual's job is. There is no job out there that can't be replaced by any of us, even you and me and everybody else. And the fact is that those that want to get ahead in the world must strive for something beyond where they're at.

You take that person at the ticket counter, that's writing that ticket for Northwest Airlines, I will guarantee you as an individual you will either condemn or praise that airline, based on that personal experience of that person that's writing that ticket or the person who greets you at the gate or the stewardess that gives you food, or whether the captain says hello, good-bye or the way that he says it to you.

Really, the destiny of that company is in the hands of the employees, based on their individual abilities to go out there and do their jobs, and reach for new stars, strive to be a better company. No matter what corporate levels of management do, they cannot replace the individual treatment that's given by their employees in the consumer business.

I will tell you that when you talk back about the self-service business, of which you were in the retail business, you can relate to this probably better than most of us can. When self-service came into effect in the grocery store business and in the general merchandising business, years ago, the biggest problem that everybody saw was pilferage, they'll steal you blind, they're going to take it all away from you, and that's the stupidest thing ever, and it started in California in the grocery business. That did not become the problem. I mean, that was the problem, stealing, but it became self-service, it became a way of life in business.

I had an experience here about 6 months ago, in this town, I won't say where it was, where I went shopping with my wife and a couple of my kids at a store. Picked out a bunch of things, filled up the cart and was going to check it out, and I was in line, as three other people were, and I was watching the person in front of me be treated as if this person was a criminal or didn't belong in that store. I watched the next person, same thing. And I got up there, didn't say a word to me, and I started putting my stuff out of the cart and she said, "Leave the stuff in the cart until I take it out." I said, "Pardon me?" She said, "I will tell you when to take the stuff out of the cart." I said, "No, you won't, because here's the whole cart. I'm leaving." And this is a store that I own, I want you to know.

Senator BOSCHWITZ. You own it?

Mr. JACOBS. Yes. And that person is no longer there, obviously. But let me tell you what's important to me, what that experience proved to me. I saw two people, beside myself, going through being treated not as a customer, but as somebody who wanted to throw you out, didn't want to do business. What could management do any different? Obviously, not have the person there, but, I mean, what could we as management or they as management do to offset that experience? Let me tell you, it would be very difficult and if I was any one of those people that stuck around, I would have never stepped foot in that store again. But there was things, you have to train people.

The point I'm making is people that are what we believe is so-called minimum wage, has more impact than the chairman of the company does, based on individual experience. We can't lose sight of the fact that people have more to say and do with success or failure of business then they believe they do. They think they're peons, they have nothing to say. That's absolutely untrue. And I will tell you, the people who have the interest in getting ahead in the world, and if you monitor them no different then you put something around and watch people, the next 6 months you can see who the winners and losers will be in life, based on the experience of those 6 months of watching them do their job.

Senator BOSCHWITZ. We're going to have to move along, we've got some other witnesses.

As they say, I could talk to you all morning.

I guess I would like you to include in your review from the Minnesota standpoint, since this hearing is being held in Minnesota, the companies that you have either taken over or created here in Minnesota and what has become of them in the interim.

Mr. JACOBS. You said you would like something to——

Senator BOSCHWITZ. I would like you to review that, if you will. Since we talked about——

Mr. JACOBS. Here, now?

Senator BOSCHWITZ. Here in Minnesota, without speaking in broad——

Mr. JACOBS. Well, just basically, we're in several industries here. One is the boating business. We have 23 plants in the United States of which four of them are here in Minnesota. London, New York Mills; Larsen and Crestliner in Little Falls. We have a company down in Winona, MN, which is, oh, a company over 100 years old. We bought it in bankruptcy in 1978. Had about 3,500, 4,000 direct selling people at that time, very successful company. Now have 40,000 people in the United States and Canada, direct selling.

We have a company called Brown-Minneapolis Tank, which is a manufacturing company, very competitive business, and really paid the price in the oil downturn. Was a fabricator of underground tanks and above-ground tanks. We made a decision that we were going to be a long-term player and went out and bought out our competition, two other facilities, one in Birmingham, AL, and Provo, UT. We've become a so-called major-league player in the underground tank business, which, you know, all the gas stations are being asked to change today for pollution, that's tanks that we built. Insty-Prints, which is one of our home offices here, for that company. CDN, which I've been associated with and a part of, it's a

company that was started by Ted Dicor and myself in 1984, from 80 some people, it's up to just over 4,000 people.

Senator BOSCHWITZ. All in Minnesota, most of them?

Mr. JACOBS. Yes. Well, we have another facility, but just over 4,000 here. They're in the middle of a takeover right now. It's public knowledge that CDN has received offers from competitors. But as we tell our people, we think they're the greatest asset that there is, you know, for this, and it's something that I want to see. I'm very optimistic. My optimism toward it is really toward the future business. Whether they're there or not doesn't make a difference, the people there will make the difference. They've got their corporate headquarters here.

Senator BOSCHWITZ. All right. Thank you for coming down this morning and it's nice to have you as a friend. Your testimony has been helpful.

Mr. JACOBS. I hope so.

Senator BOSCHWITZ. It was.

Mr. JACOBS. Thank you.

Senator BOSCHWITZ. And that you've been a major player and a contributing factor in the economy of our State and the Nation.

Mr. JACOBS. I hope so. Thank you.

Senator BOSCHWITZ. Thank you very much for coming.

We now will turn to Professor Paul Reynolds. And, Professor Reynolds, we also have some patience with respect to your testimony, so while the 5-minute rule sometimes applies, you proceed as you wish and if you want to give your entire testimony, that will be just fine.

STATEMENT OF PROF. PAUL D. REYNOLDS, DEPARTMENT OF SOCIOLOGY, UNIVERSITY OF MINNESOTA, MINNEAPOLIS, MN

Professor REYNOLDS. Thank you. I want to say thank you very much for letting me join the group.

I have had a fascinating experience over the last 5 or 6 years studying the structure of new firms and entrepreneurship in the country. I find that what I'm going to be doing is amplifying some of the comments that Irwin Jacobs made, in perhaps a slightly different form.

I focus my attention on the issues raised in the letter of invitation having to do with the effect of the takeovers on opportunities for small businesses. Having looked at this area for some years, it seems to me that the opportunity for small business is so dramatic, in a sense of high levels of new business creation, that the small number of takeovers is probably not going to make much difference; that is, have a big effect on the creation of new businesses.

But the tragic part is that there's no way to answer that question at this time. I will to return to that issue at end of my comments. In fact, I don't think anybody can answer that question with precision.

Senator BOSCHWITZ. Who did you say, again?

Professor REYNOLDS. I don't think anybody can answer that question with precision at this time because of the data needed is not available. That's an important issue that I want to turn to later.

I want to mention briefly several basic processes that are going on in the economic structure. Features of the economic system that are just recently becoming obvious.

There are probably four major kinds of changes that are occurring. In the U.S. economic structure there are steady increases in the number of businesses, businesses are becoming smaller, both in terms of their individual sites as well as the overall legal multi-site entities. There seems to be an increase in specialization and an increase in volatility, both higher birth rates and higher death rates. These seem to be fundamental changes in the structure of the economy.

In contrast, another phenomenon has been going on for some time, a continuous closing of businesses and replacement by others. Together these account for the 500,000 to 700,000 new businesses that come into existence every year; they involve between 1 million and 1½ million people starting these new businesses.

In light of this sort of massive turnover and changes in the structure, it's unlikely that several hundred, several thousand takeovers—which may cause restructure of the firms, people leaving firms to start new businesses, people buying parts of the business—would have major impact.

That doesn't mean, however, that for an individual industry or community that takeovers might not have a major impact. But in terms of the broader scale phenomenon, it's maybe ½ a percent, ¼ of a percent of the influence at these more prevalent processes.

This is one of the reasons I would agree with Irwin Jacobs that the economy is becoming more flexible, more competitive, more adductive, and enhancing the competitiveness on an international scale.

The disadvantage of this, and it's one that's been brought up several times already, is that if you get a higher turnover of business entities, you end up with problems providing retirement and health benefits to the individual workers. It's quite clear that it may be necessary to have a different structure provided by the public sector to take care these problems.

Now, turning to the last point. I have friends and associates in some of the major Federal agencies; Bureau of Labor Statistics, Small Business Administration, Bureau of the Census. They're all struggling with the problem of how to get an accurate count of the business entities, which is not presently available, and at the same time develop an accurate count of the number of births, deaths, changes, and restructuring of the U.S. economy. One of the major problems they confront is they're not sure what issues are going to be of continuing interest to the policymakers in the Federal Government. If the Senate Small Business Committee could provide some explicit guidance to these trained and serious professionals, that would be a great help for their future planning.

I'd be happy to answer any questions or elaborate on these comments.

Senator BOSCHWITZ. So you also feel that the whole business of takeovers, flexibility in corporations, has added productivity in our economy?

Professor REYNOLDS. I would agree across the board, I think. The opportunity to restructure, however it's done, is probably a good thing.

Senator BOSCHWITZ. And that has given some opportunities to small business?

Professor REYNOLDS. I think in individual cases there probably have been.

Senator BOSCHWITZ. What would you suggest to the Congress? Should we legislate about this matter, should we seek to, in some way, restrict the—make these transactions more difficult or should we, in some way, seek to legislate about the business of takeovers?

Professor REYNOLDS. Well, quite frankly, my area of expertise is not in the process of takeovers, it's in the study of new and small businesses, so I wouldn't have any specific suggestions at this time, other than, perhaps, some mechanism for insuring that these pension problems are taken care of.

Senator BOSCHWITZ. There's some legislation now before us about pensions and the use of the pension funds in bringing about these takeovers and whether or not the increase in the fund can be used to the benefit of the employee or the benefit of the employer.

Are you familiar with that legislation?

Professor REYNOLDS. I'm not familiar with that legislation. I am familiar with—the basic problem. As I see it, and it's been mentioned already, is that many employees find themselves in a situation where their pension rights are a function of the duration of the firm, rather than the contributions made over the time that they've been with the firm. If suddenly the firm disappears or their employment relationship is terminated before they put in their 20, 25, or 30 years, they're left with virtually nothing.

I might say that the university faculty solved this problem many years ago. Almost all universities have defined contributions plans, so each year a contribution is made——

Senator BOSCHWITZ. What contributions?

Professor REYNOLDS. Defined contributions plans. Each year you work for a university a contribution is made into a retirement fund and then at the end of 20 or 30 years that covers your retirement. That means that if you change universities, you carry that money with you. You don't lose the money because you've changed your employers.

Senator BOSCHWITZ. I recall that Senator Javits always used to talk about the portability of pensions and I am most supportive of that approach to the problem.

[The prepared statement of Professor Reynolds follows:]

United States Senate

Committee on Small Business

Field Hearing

on

Corporate Takeovers and Small Business Opportunities

Testimony Provided by

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Tuesday, 27 June 1989
10:00 AM

Moot Court Room
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NOTE: The analysis and conclusions are those of the presenter and do not represent any positions, official or unofficial, of the University of Minnesota or the Department of Sociology.

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[1]Biographical description on the last page.

- What is the effect of corporate takeovers on small business development opportunities?

- Do corporate takeovers result in a decline or expansion of subcontracting possibilities?

- Is there evidence that employees affected by a takeover use it as an opportunity to start a new business, perhaps by purchasing a division or a product line from a former employer?

As one that has pursued intensive study of new firms and their contributions to the economy, I would like to be able to provide detailed, precise answers to these questions. I can say, with substantial confidence, that no one can provide such answers because, at present, the appropriate data does not exist.

I can say, with less confidence, that unless the rate of corporate takeovers increases substantially--five or tenfold--it is unlikely to have a major impact on new business development compared to fundamental processes present in the current economic structure. Following my comments on the latter issue, I shall return briefly to the first point, the absence of a capacity to provide detailed precise answers to these reasonable questions.

Shifts in the System of Economic (Business) Organizations

Much attention has been given to the shift in emphasis from basic resource production (especially agriculture) and manufacturing to a broad range of services--distribution, information, business, health, education, social, communication, etc. There has been, however, less attention to shifts in the way economic work is organized.

There is increasing evidence of major changes occurring in the economic order:

More business entities.

- o Increases in the number of business organizations (firms).
- o Increases in the number of business establishments (individual sites).

Smaller business entities.

- o Reduction in the size of business organizations (firms).
- o Reductions in the size of business establishments (individual sites).

Greater specialization.

- o Increased specialization of business organizations (firms).
- o Increased specialization of business establishments (individual sites).

Higher volatility.

- o Higher new firm birth, or founding, rates.
- o Higher firm dissolution, or death, rates.

These fundamental shifts have been developing over the past 10-15 years. They reflect changes in final goods and services, changes in productive technology, and increases in the speed, reliability and cost-effectiveness of communication and distributions systems.

The major advantages associated with these shifts appear to be increases in the flexibility and efficiency of the economic system. They are accompanied by major shifts in the integration of the system. Most significant is the increase in the interdependence among the business entities. As each entity becomes more specialized it also becomes more dependent on others for the parts and services required as inputs for its own final products. One need only to contrast the current production of automobiles--where the productive focus is on assembly plants that put together parts from thousands of suppliers--with the plants early in this century. One famous such plant was the River Rouge facility of the Ford Motor Company, which almost created an entire car from basic raw materials. The new assembly plants are as dependent upon these systems of suppliers as the suppliers are dependent on the assembly plants.

New Firm Replacements

A major source of new firms has probably always been a continual turnover or replacement of businesses. As one owner (or owners) decides to close down a business--most closures are not accompanied by a dramatic bankruptcy--another will frequency be created to satisfy the customers of the closed firm. This replacement phenomena is a source of a substantial proportion of new firms. Just how great a proportion is not known, but it is probably a majority of the total count. They are frequently in the more stable industry sectors, where the new firm continues to use established technology and provide well accepted goods or services (new plumbers, restaurants, lawyers, small manufacturing parts, farm veterinarian, etc.).

These two fundamental processes--responses to shifts in the economic structure and replacement of existing businesses--provide opportunities for new businesses. These opportunities are most often seized by mid-career adults with post-high school education and substantial industry experience. The majority of new firms are not started by individuals driven by the desperation of unemployment. Most--80 %--are started by those who come from other organizations (usually large and established, sometimes another new firm). They appear to become involved in new firms for a variety of reasons--for autonomy and independence, for opportunities to pursue new ideas, and to accumulate wealth. Goals which they cannot, presumably, achieve in their current career context.

New Firms and Corporate Takeovers

- What is the effect of corporate takeovers on small business development opportunities?

The discussion above represents the underlying dynamics associated with the 500,000 or more new firms initiated each year by a million or more individuals pursuing new career opportunities. Several hundred, even several thousand, corporate takeovers each year would be unlikely to greatly affect the total numbers.

That is not to say that there could not be a major effect in a given industry, particularly a highly specialized, narrowly focused industry. New industries typically start with the development of new produces and technology and a proliferation of new firms. In the beginning, no one firm has a dominant market share. However, as the control of the market--or an established relationship with customers--becomes critical for success, there is usually a reduction in the number of firms as they are bought, acquired, taken-over, merge, or disappear. In such situations, take-overs have a clear impact on reducing the number of business entities. Evaluating the overall net effect for the economy may be difficult, for a smaller number of more efficient firms may be beneficial. The extreme case, with one firm in control of the entire industry, is usually not considered optimum for the society.

- Do corporate takeovers result in a decline or expansion of sub-contracting possibilities?

The answer to this question is clearly related to what happens after the takeover is complete. If the firm is restructured to eliminate internal units that have been providing goods and services, opportunities for other new businesses will develop. However, a restructuring may or may not follow a takeover.

- o Is there evidence that employees affected by a takeover use it as an opportunity to start a new business, perhaps by purchasing a division or a product line from a former employer?

There is probably evidence that this has occurred, but it is unlikely that systemic evidence exists that this is a predictable consequence of a corporate takeover.

In summary, with the exception of the effects within a single, narrowly defined industry, it seems unlikely that corporate takeovers--friendly or hostile--will have a major effect on the massive number of new firms that are founded each year.

Absence of Appropriate Data

The impacts of corporate take-overs cannot be known with precision until major changes are made in the data on the organizations that make up the economic system.

The reason the question cannot be answered is that the number of business firms (legally defined multi-establishment commercial organizations) is unknown. As a result, there is no reliable data on the number of new firms that come into existence each year or the number of existing firms that disappear from the system. What is available is a variety of data that provides some estimates--number of establishments (or sites) filing unemployment insurance tax payments, number of business deductions filed with federal tax returns, number of firms with credit ratings, number of firms identified in samples constructed for specific industries--all of which reflect some overlap and some differences. The overlap is great enough to provide confidence for general statements. The differences are great enough to preclude confidence in precise answers to specific questions such as those proposed for these hearings.

Such data, however, could be developed. There is a substantial cadre of experienced, competent, and conscientious experts dealing with this problem in a

number of federal agencies--Office of Advocacy at the Small Business Administration, Division of Occupational and Administrative Statistics at the Bureau of Labor Statistics, Economic Surveys Division at the Bureau of the Census. Since this requires major changes in the data collection procedures of major federal agencies and will take years to fully implement, these agencies are cautious about the shifts in their data sets. There are no major technical problems, the major concerns involve resources and emphasis. The available resources will allow for detailed data on a limited number of issues. A major problem confronting these agencies is knowing what questions or issues will be of continuing interest to policy-makers.

The United States Senate Committee on Small Business could make a major contribution to these efforts by formalizing those issues most likely to be of interest to the committee over the next several decades.

Paul D. Reynolds

Biographical Description

Currently pursuing two major research programs. One, with University of Minnesota economist Wilbur Maki, is exploring the role of new firms and new branch, subsidiaries in subsequent regional economic change and well-being. Sponsored by the US Small Business Administration, this project involves analysis of sub-state regional changes over a 12 year period, 1976-1988. Completion is expected by Fall 1989.

The second major research activity is a four year followup of a 1984 sample of Minnesota New Firms. This being completed with Professor Richard Cardozo, occupant of the Curtis L. Carlson Chair in Entrepreneurial Studies at the University of Minnesota, and Dr. Michael O'Connor of Carlson Learning Systems. The emphasis is on establishing survival and growth patterns of these new firms and exploring the factors that precede differences in survival and growth. As the most recent analysis of data from this ongoing longitudinal study, it is expected that additional data will be collected every two years for the foreseeable future.

Previous research involved the censuses and surveys of all types of organizations, including government, commercial, not-for-profit, and service; studies of organizational culture and effectiveness; evaluations of community agencies; surveys of victim reported crime; and experimental research on small group process and social psychological phenomena.

Major career context has been the Department of Sociology, University of Minnesota (1970-1987), where he developed an applied graduate program and was coordinator for five years. Most recently, has served as Visiting Professor of Management (1984-85) and Adjunct Professor of Management at The Wharton School, University of Pennsylvania. Other faculty positions where held at San Francisco State University and the University of California, Riverside. Educational background includes degrees in engineering (BS, U. of Kansas, 1960), business (MBA, Stanford, 1964), psychology (MA, Stanford, 1966), and sociology (PhD, Stanford, 1969).

Numerous publications have appeared in a variety of professional journals; a multitude of reports have been prepared for clients and policy makers. Three books have been published, two on the ethical issues associated with social science research and one on theory construction in social science (the latter in the 15th printing). A monograph summarizing the research program on new firms is in preparation (under contract to Jossey-Bass).

Career experience includes wide-ranging participation in professional associations; ample experience as a journal article/research proposal referee; participation (often as chair) on virtually every type of committee a university could have; a full history of funded research; and substantial service through presentations to policy-making, professional, university, and citizen groups.

June 26, 1989

Senator BOSCHWITZ. Why don't we turn now to the third witness.

I would say to any of those witnesses who have other commitments that you're very welcome to stay and I will address some questions to you as we go along.

Let me ask one other question of you and also of Mr. Jacobs.

That is, give me your reaction to the press treatment of the whole issue of takeovers, and whether or not you feel it's been helpful or otherwise. Do you have an opinion about that?

Mr. JACOBS. Well, let me say, Rudy, that you've hit really a hot button, not only for me, I think, but for everybody in America.

You have a lack of understanding of both transactions and what they're all about, in many cases, not all. There are some very capable reporters and they try to understand, if they can keep their emotions and their relationships totally away and create the writings of a so-called unbiased person, then you are going to see a better article of understanding what the transaction is. The PR firms put full-court presses on these people. I'm talking about the big scale now and dealing with Wall Street and throughout the world.

These firms, PR firms, they don't make transactions, they go out there and try to make them look better or worse, whatever they're hired to do. So, the press clearly has a lack of understanding in many cases, and, in fact, has caused some huge losses in transactions, based on that reporter's inability——

Senator BOSCHWITZ. Based on——

Mr. JACOBS. Based on that reporter's—whoever that may be—inability to explain the transaction to the general public. People react to it, obviously, based on what they hear or what they read. So, where there is not an understanding and where there is, what I believe, a lack of unbias in some cases, it's a disaster and yet there's some very capable reporters out there, as we have seen.

Senator BOSCHWITZ. I wonder if some of the other witnesses would want to comment on that, either at this juncture or during the course of their testimony.

Do any of you want to comment?

Mr. JACOBS. Let me say one other thing, by the way. What I say about the reporting isn't because I, in effect, have a problem. I mean this very sincerely. I have no problem with my personal situation. I don't agree or disagree, in many cases, with what they say. I learned a long time ago, as you did, that the person who has the most ink wins the battle and the press certainly has the ability to outlast any of us as individuals in the sense of sparring matches. So I learned from Barentz and Al Abelson that I can take them head on, but he ran a newspaper, Rudy, and I didn't. So I learned to keep my mouth shut when they start talking to individuals because you cannot win that battle.

Senator BOSCHWITZ. I've noticed some of that myself.

Fred, do you want to comment on that?

Mr. WEYERHAEUSER. No. Silence is golden in this situation.

Senator BOSCHWITZ. We will now turn to John Lindahl of Norwest Growth Fund.

John, did you have prepared testimony?

Mr. LINDAHL. Since I wasn't sure what time my flight to New York was, I did write something, but I'll try to use that and give you a copy later.

Senator BOSCHWITZ. Fine. Just so the court reporter——

Mr. LINDAHL. Doesn't have to work hard. OK. Then she doesn't have to——

Senator BOSCHWITZ. Well, she can. You know, when Senators speak on the Floor, they or their staff sometimes go onto the Congressional Record as misprinted so that their syntax can be corrected.

Sometimes, interestingly, one doesn't exactly remember the statement on the Floor as he reads it thereafter, but——

Mr. COYLE. But it's always improved.

STATEMENT OF JOHN E. LINDAHL, NORWEST GROWTH FUND, MINNEAPOLIS, MN

Mr. LINDAHL. Well, I guess I really come from the whole issue we're talking about from a little different perspective because it's looking at it from a group of transactions that really we've been involved with over the history of our fund, which would never have occurred, in my mind, with legislative restrictions on any kind of major leverage transactions themselves.

I manage a $100 million leverage buyout fund, which really acts as principal in the acquisition of small- and middle-market companies. We have acquired companies ranging in size from $8 million in revenues to $300 million in revenues. And these companies, really, prior to their acquisition, on a very traditional nature, due to the public, where they have been subsidiaries or divisions of much larger publicly- and privately-held companies or we acquired privately-held companies.

Our primary objective is to provide current shareholders or owners a rewarding and logical transition of ownership which will not be disruptive to the business or its employees. In addition, our goal is to provide our equity partners and employees with a strong foundation for future growth and creation of future value.

Our fund has not really been involved in what I would call financial restructurings of the KKR-type buyout that you may call a hostile takeover, or whatever. I look at it as a financial restructuring. However, I——

Senator BOSCHWITZ. Have any of yours been hostile?

Mr. LINDAHL. None of our transactions have been hostile. A number of the companies we have purchased have resulted from the hostile takeover.

I really look at these transactions as being very positive, in a very positive change of ownership. They tend to maximize shareholder value and really indirectly to the sale of the various parts of the businesses, are creating numerous small businesses with highly-focused management teams who raise capital commitments to focus more intently on their market niche. The management's commitment is further enhanced by its direct investment into the new entity and the resulting ownership, which motivates the group, we find as significant.

What is important to realize is that the takeover, while in my view is very positive, may represent a different view from others. But it represents but a very small percentage of the change of ownership of American business. Legislation limiting the free enterprise system from operating efficiently will curtail the logical and efficient changes of ownership which occur.

Over the last 6 years, I've acquired 14 independently-owned companies that are now all entrepreneurially-managed businesses. Two public were taken private. Seven companies were purchased with management from major publicly-held companies, and three of those were the direct result of takeovers. Four companies represented privately-held companies whose families sold to gain liquidity. And one company was a leveraged recapitalization and transfer of ownership from one generation to the next. Each company became an adequately capitalized, partially management-owned, highly focused entity in its market segment. These companies, under our ownership and leverage, have continued to grow, make appropriate capital investments, spend money on R&D where appropriate, add employees, and 60 percent of our portfolio companies have made follow-on strategic acquisitions, further enhancing the business opportunities with them with respect to the location where the companies are headquartered.

I thought it might be a good idea, since this is in Minnesota, as to some specific transactions that maybe relate to Minnesota.

Stearns Manufacturing Co. in St. Cloud and Sauk Rapids is a company which is part of a public that we took private with the management group. Since its acquisition it's more than doubled in size and point was up significantly and it more than quadrupled in profitability.

Super Radiator was acquired with management from a company called Snyder General, which had taken over McQuay Perfex. This was an example of a very viable small business created out of a hostile takeover.

We have exited that investment and substantly have sold 100 percent of the company to the management, which I think is very positive for this entire economic area.

Norwesco is a company we were recently involved with where we in management took the company prior. Since our acquisition the company has had over 25 percent growth in revenues, increases in employment, made a follow-on acquisition, a very strong penetration into its industries.

Gelco Payment Systems we also acquired with management from G.E. Credit. This was an indirect result of a hostile takeover. Gelco——

Senator BOSCHWITZ. Gelco what? What is it called?

Mr. LINDAHL. It's called Gelco Payment Systems.

Senator BOSCHWITZ. Tell me what that does.

Mr. LINDAHL. Oh, Gelco Payment Systems is a rather unique company. It's about 99 years old and they're involved in providing financial services to really the Fortune 1,000 companies. They have products called Rapid Draft and—it would take me longer than this session to try to explain exactly what they do. But it was a subsidiary of Gelco that was spun out and acquired by us after G.E.

had acquired it through the hostile takeover of Gelco, which G.E. was the purchaser.

Since our acquisition the growth has continued and employment is up 30 percent. The company has relocated its facility in Edina, and major capital expenditures have been made.

Most recently we acquired a company called Advance Machine, located in Plymouth, which I know, Rudy, you're familiar with. Along with management this was an acquisition from a controlling family. I think the acquisition is really too early to comment on, relative to what our involvement is, but I can tell you that we are committed to having future growth and have committed sizable dollars for that growth to take place.

Senator BOSCHWITZ. Tells you the principal stockholders are quite happy.

Mr. LINDAHL. Yes.

Without the ability to leverage these transactions and use many of the creative funding sources for LBO's, these transactions would not have occurred. Stockholders would not have realized the fair value and many may still be underperforming companies. The change of ownership did stimulate new ideas, fresh capital was injected into the companies and a very positive environment was created.

To develop legislation targeted at curtailing or controlling takeovers would be very detrimental, in general, and devastating to the small- to medium-size business owners. It would greatly limit their exit opportunities and limit fostering the entrepreneurial spirit of new owners. It would also negatively impact the value of businesses. The market has become very efficient and this has really resulted in enhanced value for all business owners. To eliminate the opportunity of the owner to achieve maximum value will also negatively impact his drive for success and his eventual reinvestment of dollars in the business.

In summary, let the market be unregulated without any hindering legislation and you will preserve and maximize shareholder value, foster investment, increase the employment base, and further encourage new business opportunities.

Senator BOSCHWITZ. There's some talk this year, and we've covered a little bit of the same ground, and I need to get on to Fred Weyerhaeuser, who may have a different view. But there has been some talk recently about the lowering of the capital gains tax. I formed the capital gains caucus in the Senate and I think that the lowering of capital gains rates will be advantageous, since Mr. Jacobs has pointed out that there seems to be enough capital on the market. In any event, is it necessary to do and what will be the impact if we lower the capital gains rates?

Mr. LINDAHL. I think there is a lot of capital that's available. Yet it does have to seek quality investment opportunities. I do represent kind of two halves. One the venture capital half and one the leverage buyout half.

From the standpoint of the venture industry, capital gains is an extremely important attraction to long-term commitment to long-term strategies. The leverage buyout industry is significantly different than that. We work in 5 to 7 to 10 year cycles and the ven-

ture industry works in 7 to 10 to 15 year cycles in developing the long-term products and ideas and concepts.

We buy existing well-run, profitable companies. The venture side starts with nothing but ideas and really needs to benefit from the capital gains advantages which you talk about.

Mr. JACOBS. Rudy, excuse me one second. I don't want to lose track of the subject.

You bring up the point of dividends as a possibility in being a deductible item in corporate, where they don't have a double taxation.

I think that you would find an incredible boom——

Senator BOSCHWITZ. Incredible?

Mr. JACOBS. Boom in shareholders return. If, in fact, the company wasn't being punished for creating dividends, that the single biggest thing in giving an immediate gratification to shareholders and yet reemploy that capital, I think you find more money being put off to the shareholders in a most positive way and not being worried about the short-term theory that people are talking about. But I will tell you that there isn't anybody that you can come up with a statement. I don't believe that dividends would, in fact, cure much of the things we're talking about.

Senator BOSCHWITZ. The deductibility of dividends?

Mr. JACOBS. The deductibility of dividends.

I don't think anybody would fight over capital. I mean, all that would be secondary, and yet, I'd like to see capital gains from a real business point of view and sharing your results with your shareholders. There's no better way of doing it than dividends. If made deductible, you would find a flow of money being invested in companies at a rate that you've never seen before because it's instant gratification based on results, not something that they've got to try to create in order to get away from it. And I'm sorry to interrupt, I didn't want to lose sight of that.

Senator BOSCHWITZ. You want to comment on that?

Mr. LINDAHL. I totally agree with that, Rudy. It would be—you know, we live on that kind of a philosophy ourselves and that we do look at taking dividends out of the companies that we really are ourselves and that is something that really motivates us as investors, and I think it would be very, very positive in today's environment.

Senator BOSCHWITZ. You know, there is a deductibility—or I guess it's not a deductibility, but rather one corporation received dividends from another corporation.

Mr. JACOBS. Eighty-five percent, but that's not for the public, Rudy, that doesn't work. That doesn't work. I'm talking sharing it directly with your stockholders. You can take as a corporation—it's now 70, I think, the rate is 70 percent, but that is not what I'm talking about.

Senator BOSCHWITZ. I'm just saying that, as you did—I mean, regretfully, we're going the other way.

Mr. JACOBS. You say we are going the other way?

Senator BOSCHWITZ. Yes. Because it used to be 85.

Mr. JACOBS. Yes. That is really a loophole for the corporation. I'm saying share with the public. You know, forget the—this is my statement. I'm many corporations and I would tell you that I'd

waive the deductibility of corporate dividends if they would share it with shareholders. I mean, I just know that the public would respond to that. Everybody is looking at income and if they're going to see minimal—I mean, there are corporations today that create restructuring, which is all based because they can't get the money to the shareholders any other way but that way and it's a double taxation.

Senator BOSCHWITZ. All right. Unless you have any further comment, John, we're going to turn to Frederick Weyerhaeuser, chairman of Clearwater Management Co.

Mr. LINDAHL. No. Thank you.

[The prepared statement of Mr. Lindahl follows:]

JOHN E. LINDAHL

SPEECH

I MANAGE A $100 MILLION LEVERAGED BUYOUT FUND WHICH ACTS AS A PRINCIPAL IN THE ACQUISITION OF MIDDLE MARKET COMPANIES. WE HAVE ACQUIRED COMPANIES RANGING IN SIZE AT THE TIME OF ACQUISITION FROM $8 MILLION IN REVENUES TO $300 MILLION IN REVENUES. THESE COMPANIES PRIOR TO OUR ACQUISITION HAVE BEEN EITHER PUBLICLY HELD DIVISIONS OR SUBSIDIARIES OF MUCH LARGER COMPANIES OR PRIVATELY HELD COMPANIES. OUR PRIMARY OBJECTIVE IS TO PROVIDE CURRENT SHAREHOLDERS OR OWNERS A REWARDING AND LOGICAL TRANSITION OF OWNERSHIP WHICH WILL NOT BE DISRUPTIVE TO THE BUSINESS OR THE EMPLOYEES. IN ADDITION, OUR GOAL IS TO PROVIDE OUR EQUITY PARTNERS AND EMPLOYEES WITH A STRONG FOUNDATION FOR FUTURE GROWTH AND VALUE ENHANCEMENT.

OUR FUND HAS NOT BEEN INVOLVED WITH WHAT I WOULD CALL FINANCIAL RESTRUCTURINGS OF THE KKR TYPE BUYOUT. THESE TRANSACTIONS, HOWEVER, REPRESENT A VERY POSITIVE CHANGE OF OWNERSHIP. THEY TEND TO MAXIMIZE SHAREHOLDER VALUE AND INDIRECTLY THROUGH THEIR SALE OF VARIOUS PARTS OF THE BUSINESS ARE CREATING NUMEROUS SMALL BUSINESSES WITH HIGHLY FOCUSED MANAGEMENT TEAMS WHO RAISE CAPITAL COMMITMENTS TO FOCUS MORE INTENTLY ON THIS MARKET NICHE. THE MANAGEMENT'S COMMITMENT IS FURTHER ENHANCED BY ITS DIRECT INVESTMENT AND RESULTING OWNERSHIP OF THE SPUN-OFF ENTITY.

WHAT IS IMPORTANT TO REALIZE IS THAT THE TAKEOVER, WHILE IN MY VIEW IS VERY POSITIVE, MAY REPRESENT A DIFFERENT VIEW FROM OTHERS. BUT, IT REPRESENTS BUT A SMALL PERCENTAGE OF THE CHANGE OF OWNERSHIP OF AMERICAN BUSINESS. LEGISLATION LIMITING THE FREE

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ENTERPRISE SYSTEM FROM OPERATING EFFICIENTLY WILL CURTAIL THE LOGICAL AND EFFICIENT CHANGES OF OWNERSHIP WHICH OCCUR. OVER THE LAST SIX YEARS, WE HAVE BEEN ABLE TO CREATE 14 INDEPENDENTLY OWNED, ENTREPRENEURIALLY MANAGED BUSINESSES. TWO PUBLIC COMPANIES WERE TAKEN PRIVATE. SEVEN COMPANIES WERE PURCHASED WITH MANAGEMENT FROM MAJOR PUBLICLY HELD COMPANIES, WITH THREE THE DIRECT RESULT OF TAKEOVERS. FOUR COMPANIES REPRESENTED PRIVATELY HELD COMPANIES WHOSE FAMILY OWNERSHIPS SOLD TO GAIN LIQUIDITY, AND ONE COMPANY WAS A LEVERAGED RECAPITALIZATION AND TRANSFER OF OWNERSHIP FROM ONE GENERATION TO THE NEXT. EACH COMPANY BECAME AN ADEQUATELY CAPITALIZED, PARTIALLY MANAGEMENT OWNED, HIGHLY FOCUSED ENTITY IN ITS MARKET SEGMENT. THESE COMPANIES UNDER OUR OWNERSHIP AND LEVERAGED HAVE CONTINUED TO GROW, MAKE APPROPRIATE CAPITAL EQUIPMENT INVESTMENTS, AND ADD EMPLOYEES, AND 60% OF THE PORTFOLIO HAS MADE FOLLOW-ON STRATEGIC ACQUISITIONS.

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SPECIFIC TRANSACTIONS WHICH HAVE OCCURRED IN MINNESOTA AND MAY HAVE MOST INTEREST TO THIS GROUP WOULD BE THE FOLLOWING:

STEARNS MANUFACTURING WAS TAKEN PRIVATE BY NWGF AND MANAGEMENT, DOUBLED IN SIZE, AND MORE THAN QUADRUPLED IN PROFITABILITY. IT WAS OUR DECISION TO SELL THE COMPANY TO A NYSE COMPANY IN 1988 TO A BUYER THAT HAD EXCELLENT SYNERGY WITH STEARNS AND A DESIRE TO COMMIT ADDITIONAL RESOURCES TO STEARNS AND MINNESOTA.

SUPER RADIATOR WAS ACQUIRED WITH MANAGEMENT FROM SNYDER GENERAL WHICH HAD TAKEN OVER McQUAY PERFEX. THE COMPANY HAS SUBSEQUENTLY BEEN SOLD 100% TO THE EXISTING MANAGEMENT.

NORWESCO WAS TAKEN PRIVATE BY NWGF AND MANAGEMENT. THE COMPANY HAS EXPERIENCED SIGNIFICANT GROWTH, MADE A FOLLOW-ON ACQUISITION, AND REPRESENTS A STRONG

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PERFORMER IN ITS INDUSTRIES.

GELCO PAYMENT SYSTEMS WAS ACQUIRED BY MANAGEMENT FROM G.E. CREDIT AFTER THE TAKEOVER BATTLES GELCO FACED. GROWTH HAS CONTINUED, EMPLOYMENT IS UP 30%, THE COMPANY HAS RELOCATED TO ITS OWN FACILITY IN EDINA, AND MAJOR CAPITAL EXPENDITURE COMMITMENTS HAVE BEEN MADE.

ADVANCE MACHINE WAS ACQUIRED WITH MANAGEMENT FROM THE CONTROLLING FAMILY AND THERE IS A STRONG ON-GOING COMMITMENT TO OUR MARKETPLACE AND THE EMPLOYEE BASE.

WITHOUT THE ABILITY TO LEVERAGE THESE TRANSACTIONS AND USE MANY OF THE CREATIVE FUNDING SOURCES FOR LBO'S, MANY OF THESE TRANSACTIONS WOULD NEVER OCCUR. STOCKHOLDERS WOULD NOT HAVE REALIZED FAIR VALUE AND MANY MAY STILL BE UNDER-PERFORMING COMPANIES. THE CHANGE OF OWNERSHIP DID STIMULATE NEW IDEAS,

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FRESH CAPITAL AND A POSITIVE ENVIRONMENT.

TO DEVELOP LEGISLATION TARGETED AT CURTAILING OR CONTROLLING TAKEOVERS WOULD BE VERY DETRIMENTAL IN GENERAL AND DEVASTATING TO THE SMALL TO MEDIUM SIZE BUSINESS OWNERS. IT WOULD GREATLY LIMIT THEIR EXIT OPPORTUNITIES AND LIMIT FOSTERING THE ENTREPRENEURIAL SPIRIT OF NEW OWNERS. IT WOULD ALSO NEGATIVELY IMPACT THE VALUE OF BUSINESSES -- THE MARKET HAS BECOME MORE EFFICIENT AND THIS HAS ENHANCED THE VALUE OF ALL BUSINESS OWNERS. TO ELIMINATE THE OPPORTUNITY OF THE OWNER TO ACHIEVE MAXIMUM VALUE WILL ALSO NEGATIVELY IMPACT HIS DRIVE FOR SUCCESS AND HIS EVENTUAL REINVESTMENT IN THE BUSINESS.

IN SUMMARY, LET THE MARKET BE UNREGULATED WITHOUT ANY HINDERING LEGISLATION AND YOU WILL PRESERVE AND MAXIMIZE SHAREHOLDER VALU'E, FOSTER INVESTMENT, INCREASE THE EMPLOYMENT BASE, AND FURTHER ENCOURAGE NEW BUSINESS OPPORTUNITIES.

Senator BOSCHWITZ. Do you have preprinted testimony, by any chance?

Mr. WEYERHAEUSER. I believe it was delivered to your office.

Senator BOSCHWITZ. I may have it. Here it is.

STATEMENT OF FREDERICK T. WEYERHAEUSER, CHAIRMAN, CLEARWATER MANAGEMENT CO., ST. PAUL, MN

Mr. WEYERHAEUSER. Senator Boschwitz, I certainly appreciate the opportunity to appear before your committee.

I would like to start out by saying that I would agree with a great deal of what Mr. Jacobs has earlier said.

Mr. Jacobs, in his takeovers, brings something to the companies that he acquired in that he is an operator. I respect him as a good operator and he has done something for the companies that he has acquired.

Unfortunately, my experience in this field is that the typical takeover does not lead to that type of thing. The people that acquired the company that I work for, Conwed Corp., did not know what they had bought, did not know what to do with it. As a matter of fact, I was asked to tell them. They were upset because the memo I wrote them was 1½ pages and was—they didn't want to take the time to read it. I can tell you that they have done nothing except retract resources from that company since. And that will be the basis of some of the recommendations that I am going to make to your Committee today.

As president and chief executive officer of Conwed Corp. in Saint Paul from 1972 to 1985 and as a director of other corporations, I have had several experiences in the takeover game.

More specifically, Conwed Corp. was sold in a hostile takeover in 1985. Additionally, I was involved in selling one company on a friendly basis, liquidating another and successfully fighting off two hostile approaches. All of this has caused me to become somewhat philosophical on the issue. I believe firmly in the free enterprise system and that it should be allowed to run its course and that the current restructuring of U.S. business is, in total, positive.

However, I believe it is also necessary for business and Congress to consider taking steps that assure all participants are treated fairly. We, in business, should not forget that a corporation is a franchise given by the public and, if abused, may be taken away.

The principal problem that I encountered in defending Conwed Corp. in its battle was the legal requirement that my sole responsibility was to the shareholders. I was told repeatedly by our attorneys that I could not bargain with the acquirers for the benefit of the employees without risking a lawsuit for not properly representing the shareholders.

I am happy to say that I did find a way around this, a way of bargaining, both for the shareholders, and assuring that our employees were given a reasonable severance arrangement, contractually. In spite of what I was able to accomplish, the big losers in Conwed Corp. were the employees. The biggest losers were the senior employees, in terms of age and in position in the company.

Particularly hard hit were the long-service employees who were not yet eligible for early retirement. A 30 year employee, 54 years

old, loses substantial pension benefits and finds it difficult to find a comparable new career. I feel that business should be encouraged to do what many of us would do anyway and that is provide for a reasonable severance arrangement in the event of a hostile takeover.

The 3-year limitation on golden parachutes for top management is a reasonable approach. However we need many more of the so-called "tin parachutes" for nonmanagement employees. I am proud to say that as chairman of the compensation committee, the board of directors of Potlatch Corp., I have been instrumental in granting tin parachutes for all salaried employees. This is a reasonable guarantee that in the event that somebody takes over the company on a hostile basis, that they will be treated fairly.

It's been my experience that shareholders are winners in takeovers and that they are receiving expedited payment for value that may be realized in the future. However, not all shareholders are necessarily treated equal. In this area, I have two specific recommendations. The first addresses Greenmail, which, by the way, I have paid. However, in paying Greenmail, our board of directors took a unique position and that was that we were willing to offer the same price to any other shareholder that wished to sell at that price. I do not think it is unreasonable to require that any company that buys its stock must make the same offer to all shareholders.

I do not have a good answer for my second shareholder recommendation except that I am convinced many shareholders are stampeded to sell because they are afraid that the raider will get 51 percent of the company and effectively freeze them out. We must find a way to assure that minority shareholders are not abused.

Finally, I will say little on the benefits to raiders created by the tax deductibility of interest payments and the nondeductibility of dividend payments. I am sure you have heard a great deal of this issue and I consider the U.S. Government is clearly a nonbenefitting contributor to the leveraged buyout hostile takeover binge we are currently experiencing.

What I would like comment on, that I personally would like to see the elimination of double taxation on dividends.

Finally, you asked a question on capital gains. Capital gains taxes have treated the person that buys stock and holds it for a relatively short period of time the same way that somebody that builds a company over a lifetime is treated. And I personally am very much in favor of the time-waited concept of the capital gains taxation.

In other words, somebody that's held something for a long period of time should not be taxed for the inflationary results and also should get some benefits for owning and building that company.

I'm certainly open to any questions you'd like to ask.

[The prepared statement of Mr. Weyerhaeuser follows:]

TESTIMONY BY F. T. WEYERHAEUSER, CHAIRMAN, CLEARWATER MANAGEMENT COMPANY, TO THE UNITED STATES SENATE COMMITTEE ON SMALL BUSINESS TUESDAY, JUNE 27, 1989, HAMLINE UNIVERSITY SCHOOL OF LAW, SAINT PAUL, MINNESOTA

Ladies and Gentlemen:

I appreciate your giving me the opportunity to appear before you today. As I have only been allocated five minutes, I will try and get quickly to the point.

As president and chief executive officer of Conwed Corporation in Saint Paul from 1972 to 1985 and as a director of other corporations, I have had several experiences in the takeover game. More specifically, Conwed Corporation was sold in a hostile takeover in 1985. Additionally, I was involved in selling one company on a friendly basis, liquidating another and successfully fighting off two hostile approaches. All of this has caused me to become somewhat philosophical on the issue. I believe firmly that the free enterprise system should be allowed to run its course and that the current restructuring of U.S. business is in total positive. However, I believe it is also necessary for business and Congress to consider taking steps that assure all participants are treated fairly. We, in business, should not forget that a corporation is a franchise given by the public and, if abused, may be taken away.

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The principal problem that I encountered in defending Conwed Corporation in its battle was the legal requirement that my sole responsibility was to the shareholders. I was told repeatedly by our attorneys that I could not bargain for the employees without risking a lawsuit for not properly representing the shareholders.

I am happy to say that I did find a way of bargaining, both for the shareholders, and assuring that our employees were given a reasonable severance arrangement. In spite of what I was able to accomplish, the big losers in our situation were our employees. The biggest losers were the senior employees - both in length of service and position in the company.

Particularly hard hit were the long service employees who were not yet eligible for early retirement. A thirty year employee 54 years old loses substantial pension benefits and finds it difficult to build a comparable new career. I feel that business should be encouraged to do what many of us would do anyway and that is provide for a reasonable severance arrangement in the event of a hostile takeover. The three year limitation on golden parachutes is a reasonable approach for top management who will have difficulty in finding comparable employment. However, we need many more of the so-called "tin parachutes" for nonmanagement employees. I am proud to say that as chairman of the Compensation Committee for Potlatch Corporation, I have been instrumental in granting tin parachutes to all salaried employees.

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I do not have a good answer for my second shareholder recommendation except that I am convinced many shareholders are stampeded to sell because they are afraid that the raider will get fifty-one percent of the company and effectively freeze them out. We must find a way to assure that minority shareholders are not abused.

Finally, I will say nothing on the benefit to raiders created by the tax deductibility of interest payments and the nondeductibility of dividend payments. I am sure you have heard a great deal on this issue as the United States Government is clearly a non-benefiting contributor to the leveraged buy-out hostile takeover binge we are currently experiencing.

Thank you. I would be glad to answer any questions you might have.

Senator BOSCHWITZ. I'd like to say that Senator Armstrong and I have introduced legislation and I'd also like to make a short decision about capital gains and tell you where it's going.

We've introduced just that kind of bill that, on the basis of the asset we allowed the rise with inflation and then the rate of taxations be the regular rate of the taxes, at the present rate we think is equitable.

I think that something like that may happen. The question then becomes how far back do you go. Something that you and I or somebody may have acquired 20 years ago would go all the way back. It does not appear that the Congress wants to do that. We really haven't talked about whether or not we should seek to do that. They're talking about going back to 1986 and in the interim, for a couple of years, lowering the rate to 20 percent.

At the time the Budget Committee this year acted on the 1990 budget, some of us decided that we would try to impact the capital gains by reconciling the revenues. That is when the budget is made out, all of the numbers that we put out are really just topics of the nonenforceable. Unless we reconcile the revenue numbers, some of the other numbers—well, when you reconcile, then you force the committees to act to meet those—they're no longer targets but advantages. We mandated $5.3 billion of additional revenue.

How do you raise that? You raise the gasoline tax 7 cents. But that's a pretty hard vote. All the farmers and everybody else comes down on you like a ton of bricks. The tax may be responsible environmentally, but that's a different matter.

Or you can—my friend Pat said we want to close a lot of loopholes. Well, the obvious loophole is about $250 million. They're hard to find, very frankly, but if you close a lot of them—and I said, if you want to take on—21 times 250 would be about $5.3 billion. You want to take on 21 foreign special interest groups, good luck. I know we can do it and I'm not sure that I want to do that.

And it's interesting to note $5.3 billion, the amount of the increased revenues that we mandated, is exactly at the amount, just by chance, exactly the amount that would be realized in the event you lower the capital gains rate to 20 percent.

So we're hopeful and we're fairly optimistic that this will happen soon. "Soon" being before this year, so that it will take effect this year, so that people will go make the sales.

I have a hard time convincing some of my colleagues that by lowering the rates you increase the revenues. I finally have come down to describing it to them and saying, listen, did you buy that suit on sale that you're wearing? Oh, sure. And that car that you bought, that was bought on sale, too? Yes. I said, well, the price is a tax table and if you lower it, you're going to engender greater volume. And I got some of them convinced. But now you have to tell them that—somehow eliminate to them how you're not enriching the already riching. And so I tell them about the farmer who holds on, as you were talking about, or the small businessman who has a hardware store. By the time he gets the building paid off and got the inventory all paid for and he sells the business, that year he's rich. And then the next year he goes back to his regular status.

We have made considerable progress in all these arguments about capital gains and to the stratagem of reconciliation. We have indeed maybe accomplished that goal. But I found also in the legislative process, don't count those chickens too soon. I don't intend on doing that.

I wonder if some of the other witnesses would have some opinions on Greenmail. Professor Reynolds or Mr. Jacobs?

Mr. JACOBS. Well, I've commented publicly to it, two things. First of all, it is not—if there's anything wrong with Greenmail, nobody's put a gun to anybody's head and told them if you hate Greenmail I'm going to blow your brains out. Greenmail is initiated by the people who do not want the person intruding on that, for whatever reason. That's one.

Two is, I've said openly I'm against it, the system allows it where it allows it, and doesn't. We have been accused of Greenmail in many cases and I'd like to debate each and every case as to what the circumstances were surrounding it, but I'm not going to sit here and defend myself with that.

I would be against Greenmail as an absolute fact and I think there's enough now in the system, frankly, that disallows Greenmail the punishment of overproductability and tax ramifications, too, I think, really resolve that. So I don't think Greenmail is really the case anymore, or anything to speak about.

Rudy, I just want to say one other thing and I'm going to have to leave here. But we've heard here today really two things, the dividend situation and the capital gains, the big two issues. I don't know—obviously, there are statisticians, statistics people, specifically in Washington, that could clearly come up with the numbers on this, both at the IRS and I'm sure a special situations. But it's my belief that the greatest stimulant that this country could have, and impact worldwide, as an absolute fact, both from the public, job, growth, businesses, communities, every possible area, would be the capital gains and the dividend deductibility, would be the greatest single stimulant that you could pass upon the system.

I can't sit here today and tell you what that will cost or bring into the Government, but when people are spending money, the Government is collecting money. And when people are investing money, businesses are paying taxes. The cycle that would be created would be mind-boggling from every business circle, everywhere. I don't know that there would be one business outside of people that are trying to create loopholes to get away from these types of things, that deductibility of dividends and capital gains. And I don't have a problem with that capital gains was 2 years, 3 years, 4 years, it doesn't make any difference to me. It is a way for our people who want to invest that way and they should be rewarded for it, as far as I'm concerned.

Senator BOSCHWITZ. Yes. My approach to capital gains is for a longer term because I think people who make a longer term investment are different than between people who are in and out. So, I've also introduced a bill where there's a 3-year holding period that's one rate and a 5-year holding period that's another rate.

Mr. JACOBS. Keep it simple, Rudy. I've got to leave here.

Senator BOSCHWITZ. Let me tell you that it's unfortunate that I have not thought before of introducing legislation. We will talk

through about the deductibility of dividends by corporations or that they not be taxable to the recipients. But it would be a large loss of revenue and then you make the argument to the Federal Government that, yes, you will get all of this enhanced economic activity. And therefore, if you're willing to stand the gap of perhaps the immediate loss, you're going to make it up in the longer run.

Mr. JACOBS. There's limitations. You don't just give people the right to take the amount of business loss that they want, which you do if you take away the question of restructuring versus the ability to get some money you show on a regular basis. You would preclude many, many of the so-called situations where the Government is paying the interest they're allowed. You know, we just heard that the fact that the Government is allowing LBO's, or whatever else it is, and restructuring and they're paying interest bill. I think you would find that you're actually gaining, and I don't mean just in the long, long term, I mean relatively short term, that you'll find. And you've got to remember that on the international markets, we are at a disadvantage when buying corporations, based on the tax situation, whether it be Japan or Europe, and the availability to deduct goodwill, where we do not have that going for us here, takes 40 years. That what you want to do is create an avenue that people don't have to look at that, they're so stimulated to go out there and create businesses because there are rewards on a regular basis to do this with, that you can't forget these international markets, there's a lot of international players in this country today and yet America is not being sold away as many people believe. But the fact is that it should be something that should be made an awareness to and something that we should be focusing on. The best way to combat that is to reward our people here.

Senator BOSCHWITZ. We'll look at that and we'll look at what the revenue impact of that would be. And I'm sorry to tell you that the Treasury and the OMB will not say that, yes, we can do this. They will not consider that there might be additional revenues created because of doing something that has economic success.

It's unfortunate that——

Mr. JACOBS. We both agree on that.

Senator BOSCHWITZ. They're making assessments. Maybe we ought to get them to try to change that.

Mr. JACOBS. I have to leave. Thank you.

Senator BOSCHWITZ. See you later. Thank you for coming.

Mr. WEYERHAEUSER. Senator, could I make a comment?

Senator BOSCHWITZ. Certainly.

Mr. WEYERHAEUSER. First off, Greenmail is very hard to define——

Senator BOSCHWITZ. What's that?

Mr. WEYERHAEUSER. Greenmail is very hard to define, but I've paid it twice, been involved in paying it twice and in both instances the shareholders benefited in real terms in very short order. I appreciate your comment on the Government, but at the same time, I think the Government is the biggest loser in this deductibility of interest, taxation of dividend, when you look at the mathematics.

I'm sure one of the big factors in the Northwest Airlines takeover was that the interest that's going to be paid on that money is

deductible, where the dividends that are paid to the shareholders are not, which clearly affects the value of the stock. I think you could build a pretty good case. At least bringing on a new cost and balance in some way or another would be beneficial to a business and would not be a revenue loser.

Senator BOSCHWITZ. I agree. I take the longer view, I'm afraid, that some of my colleagues, and people who score, they say, the budget amendments and the amendment.

I also find very interesting your comments about so-called tin parachutes. Have you thought of what we can do for the 30-year employee who loses a substantial part of his benefits at age 54?

Mr. WEYERHAEUSER. I've thought a lot about it. Traditionally our pension plans are defined benefit plans, which went with a whole set of rules that generally cut off at age 55.

I think today I would look much more to defined contribution plan, which, in effect, makes the pension portable to the employees.

When I was involved, I thought the 401K plans, if allowed to run their course, were probably going to replace the defined benefit plans over a period of time.

Unfortunately, Congress restricted the amount that they could put into one of those. But today I would definitely look at a concept within my own company that allowed portability for the employee, so that if they lost their job before they were eligible for early retirement, they would not take a huge discount.

Senator BOSCHWITZ. In 30 years most of them must have vested?

Mr. WEYERHAEUSER. They're vested, but by leaving the company before 55 they took a different discount factor and many of them have to wait until 65 to get anything. And the result is with inflation that that pension is not worth what it might have been and they can't work for anybody else long enough to build a new pension plan.

Senator BOSCHWITZ. We will look into that, too, because these cutoff type of things are kind of an invitation for mischief or an invitation for having people taken advantage of. We'll toss it in——

Mr. LINDAHL. Rudy, can I make one comment? And I guess I ask Ted as to how far tin mail goes, or whatever it's called, the tin parachute, because I guess one of the concerns I have is that we have seen an awful lot of underperforming companies that do need—really from a survivability standpoint because of a company restructuring. And I really don't think it's in the best interests of the economy or that company going forward, for a new buyer to become obligated to try and solve a poorly-run or poorly-managed company's personnel problems.

Mr. WEYERHAEUSER. I am fully appreciative of what you say. However, I don't think that you can ask the employee that has worked for a company for his entire career to be the person that pays for the restructuring. I think there is an obligation by the companies to find ways of doing it by changing our pension plans, severance arrangements. I'm just talking about a reasonable severance that most of us would pay the employees if we were running the company. It's all too easy for somebody that doesn't know any of the people to come in and just let them walk all over. I would dare to say that people wouldn't do that, yourself.

Mr. LINDAHL. We haven't had to.

Mr. WEYERHAEUSER. Yes. That's my point.

Senator BOSCHWITZ. Well, let's turn to Dr. Erickson. You've been very patient with us. Let me just find your paper.

Dr. ERICKSON. I have several copies of my testimony and I'll try to summarize it, since the hour is late.

Senator BOSCHWITZ. That's all right. You've been patient as the last witness. You know, it's like being a junior Senator, both of you, and we will see to it that the testimony be made available to the other Senators.

Let me be honest with you, it's unlikely the other Senators will read it, but nevertheless, it will get read and summarized so that my colleagues are made aware of it.

Very often in a table like this it will go all the way around and we have 16 Senators and there will be one witness. By the time the junior Senator gets called upon you for questions, they've all been asked, so, in a way, the final witness has that problem.

Well, if you will proceed.

STATEMENT OF DR. W. BRUCE ERICKSON, CO-CHAIR, DEPARTMENT OF STRATEGIC MANAGEMENT AND ORGANIZATION, CARLSON SCHOOL OF MANAGEMENT, UNIVERSITY OF MINNESOTA, MINNEAPOLIS, MN

Dr. ERICKSON. Thank you. I appreciate your comments and thank you for inviting me.

I'd like to speak of a takeover situation from the viewpoint of venture capital and particularly new firms. And I had a graduate student, Isiah Fox, look at the literature, the academic literature, on the effect of takeovers in small business and he could find none, which is an interesting phenomenon in itself.

What I'm going to say, then, is based on my experience on about 10 boards of directors and also trying to assist about 30 small businesses, largely in the high-tech area, get started.

I believe that takeovers, particularly the large takeovers, have a slightly adverse effect on high technology and new start-ups. But the solution to the problems do not lie in Federal legislation, but rather in a different treatment in terms of capital gains, and I'll get to that.

Let me talk for a moment about some of the specific problems that large-scale takeovers, I think, create for small, new start-up, high-tech businesses and this is based on experience.

First of all, there are some positives. If you look at the situation from new business ideas, if there is restructuring, some people leave and they start up new businesses, the companies, some of them are high-tech businesses and that may add to the supply of the new business ideas. And I've seen this in a couple of cases.

However, I think in the long run there are some problems in terms of the development of new ideas. As I've observed, especially with large takeovers, the research and development efforts of them, I think the level of research and development activity often is cut, and there's some debate in the literature on this.

More importantly, I think the research and development activity that occurs, occurs in short-term efforts that will resolve an imme-

diate commercialization of products, and thus, I think that I observed some lessening of the new ideas that are coming from large businesses that have been taken over versus large businesses which have not been taken over.

A second part of some of the problems that I see with takeovers is in terms of the resources that takeovers provide to small new start-ups. Typically, in the past start-ups have obtained capital, sometimes some venture capital firms and I think that the sources of venture capital have diminished, and there are probably three reasons for that: Stock market crash, which has made existing stocks cheap, the change in the capital gains rates, and the initial public offering market, that occurred roughly since 1984.

The result has been that increasingly small high-technology start-ups try to obtain support from what is sometimes called the corporate sponsorship approach. They try to seek out sponsors among large companies to help them raise venture capital, to give them reputation and validity, and to provide business advice to them. That route has become, in recent years, a bit more important than it used to be. Maybe as important as actually raising of capital in more conventional ways.

If we look at the corporate sponsorship approach, large takeovers, I think, have few adverse effects. Several companies I know which have had deals near complete for marketing and for financing from corporate sponsors, once a takeover is contemplated, is occurring, and to some extent, perhaps as much as 1 year after the takeover has happened, find that the attention of management is so devoted to the takeover that their deal goes nowhere and that could be critical to a start-up.

Second, many companies, large companies, have had arms of the companies that have resources that they devote to investing in small businesses. Often during takeover periods, those venture arms of corporations find their funding cut off or reduced substantially and the money is devoted to paying off debt or other devices.

Third, the managements of companies that are taken over sometimes have short-term orientations to meet their debt payments and as a result they are not interested in sponsoring smaller companies, especially in high-tech areas, and especially at the early stages where there's a long term required before the effort will become profitable.

Also, I think that the time and intention that management can devote to helping solve ventures, decreases, in its taken-over company or a company under threat of takeover because management's attention is often devoted to the takeover, rather than to the small business that needs their help sometimes.

And finally, I think that with some of the takeovers where there's not a spinning off of some of the units, the corporations get larger and more bureaucratic. And there have been several instances of this where the company has gotten so bureaucratic that—after a takeover, that you have to go through a whole different set of committees to get venture capital funding.

Now, the positive part of the takeover effect is that, in terms of financing new and specially high technology businesses, one of the keys to obtaining financing is either to take the company public or to have what is called a venture capital come in and do frequently

exit potential. That is the ability to take the company public or to sell it to a larger firm.

Having a large number of takeovers in the economy benefits firms because it increases the exit potential. And that's why I think that Federal legislation, if it's to deal with takeovers, has to be very carefully drafted because if it eliminates part of the exit potential, it could have serious adverse effects on new high technology ventures.

My conclusion in all this, then, is, new ventures, and especially those in high technology businesses, are desirable, and I believe they are, the proper approach is not to deal with takeovers, but to try to deal with incentives to provide long-term capital and that's why I'm so attracted to a system such as you're describing, Senator Boschwitz, where you reward people who make long-term investments by systematically decreasing the capital gains tax with time. I believe this would have a more positive effect on new start-ups than would trying to legislate takeovers. Thank you.

Senator BOSCHWITZ. I thank you for your testimony, Dr. Erickson.

It seems to me that I've seen statistics that research and development increase after takeovers.

Dr. ERICKSON. As I said, the literature is mixed on that. I've seen reports on both sides and you could make a case for either side. That's why I said in my testimony that the evidence is mixed. I've seen academic studies on both sides. But you are correct, there is some evidence that it actually goes up.

Senator BOSCHWITZ. You point out some of the difficulties inherent in takeovers. Nothing ever comes out quite perfectly, by any means. Then you concluded by saying it's kind of difficult to legislate.

Dr. ERICKSON. Right.

Senator BOSCHWITZ. Before I conclude here, I have to ask if you can point me in a more specific direction with respect to how do we legislate about this. Besides that, you seem to have some doubts about whether or not we should. In the balance, do you think we should or should not?

Dr. ERICKSON. First of all, I think that the capital gains type approach that you're proposing is the most important single thing you could do to help small high technology businesses and small businesses, start-up businesses, in general.

Second, with respect to takeover legislation, if there is takeover legislation, because of the importance of exit to small business selling off to larger businesses, in terms of attracting people to invest in small businesses, I would suggest some sort of downward limit on the legislation, so takeovers of under $100 million are exempted from the legislation. I reach no judgment——

Senator BOSCHWITZ. But that's a very large takeover. I mean, we're talking about——

Dr. ERICKSON. Yes. You might say $50 million or $20 million. I just used that as an example.

Senator BOSCHWITZ. That's still a pretty big takeover, you know.

Dr. ERICKSON. Well, let me give you an example——

Senator BOSCHWITZ. Lots of people can work for a company that size.

Dr. ERICKSON. A local company called Filmtec, that was a great success, that you may be familiar with, resulted from venture capital investments starting in 1978 and was sold to Dow Chemical for $70 million. The opportunity to sell that venture about 2 or 3 years ago, as I recall, I think helped induce venture capital. So, if you excluded the possibility of selling out such companies, and in this case it is a $70 million transaction, I think that you would have reduced the attractiveness of investment in a company like Filmtec, which has created lots of jobs, and so on. So that's why I used the figure $100 million because there are some companies like that. Ongeomedics is another one. Where you were talking about tractions involving $60 million, $70 million, $80 million, I think I would need further study to get the precise amount, but I think the principle of allowing takeovers of smaller businesses to enhance the exit potentials is a sound one.

[The prepared statement of Dr. Erickson follows:]

Testimony
W. Bruce Erickson
Senate Committee on Small Business
Tuesday, June 27th

I am Bruce Erickson, a professor in the Carlson School of Management, and Co-Chair of the Department of Strategic Management and Organization. I am a professional economist, and have served on the Board of Directors of about 10 small start-up businesses and have served as an advisor to several venture capital funds. I thank the Senate Committee on Small Business for the opportunity to testify in Minneapolis today.

My testimony is based largely on personal experience rather than on research studies concerning the effects of takeovers on small business.

The effects of takeovers, including hostile takeovers, on small businesses can be considered first from the viewpoint of the start-up business and second from the perspective of the existing small business. Start-up businesses can be analyzed in terms of the supply of new business ideas created and in terms of the entrepreneur's ability to find capital and other resources to help build his or her business.

The primary effect of takeovers on the supply of new business ideas is, I believe, largely neutral. Takeovers usually create "restructuring" -- often a euphemism for layoffs -- and a certain portion of those laid off do go into business for themselves. In my observation, the bulk of the layoffs are in middle-management, marketing, and financial areas -- not in scientific and technical areas. The result is that many of the new businesses created are in the consulting and business service field. Although many of these businesses do not prove to economically viable, the successful ones are valuable in themselves but rarely provide the new products or services that are vital to the American economy. Also, because takeovers today usually involve the

creation of large debt, research and new product opportunities may not be as vigorously pursued by an acquired company as they would have been prior to the takeover. This can create incentives for managers, scientists, and engineers to start their own new enterprises to exploit these opportunities.

Offsetting this, however, are two factors. First, total research and development expenditures may decline as an acquired firm devotes more of its revenues to paying off debt after the takeover (my reading of the current, still fragmentary, research evidence is that the effects of takeovers on research and development levels are mixed). Second, my observation is that the focus of research and development after a takeover often shifts to exploiting relatively minor product variations and nuances, and toward ideas with short-range commercialization payoffs. If either or both these factors are active, I believe the number of viable new ideas coming from larger businesses and transferred to new start-up businesses (which normally transfer many such ideas to new ventures because of differing assessments of their value, higher costs of serving small markets, or inconsistency with the corporation's strategy) will fail.

On the resource side, I believe the effect of takeovers on new ventures has been almost entirely negative. First it should be observed that the change in capital gains taxation, the October 19, 1989 market crash, and lackluster performance of the initial public offerings market since 1984 has made is more difficult for new start-ups to raise venture capital. This has enhanced the importance of "corporate sponsorship" in developing new businesses. The corporate sponsor often provides some combination of producer reputation, financial resources, business and technical advice, and marketing clout to the start-up business.

The effects of takeovers, either friendly or hostile, among the larger businesses are deleterious to new ventures for several reasons:

- In the transition before, during, and for a considerable period after the takeover, potential corporate sponsors rarely make decisions concerning corporate sponsorship until any new managers are installed and any changes in corporate strategy are made.

- Often, with high debt levels, financial resources are less available for sponsored new ventures from companies subjected to a takeover or those that use debt to repel potential takeovers.

- Takeover or merged companies with high debt levels often are oriented to short-term profitability to pay off debt or to protect themselves from future takeovers. New ventures typically are profitable only in the longer-run; hence they are less attractive investments for the companies.

- Takeovers divert management's time and attention, and usually reduce the number of mangers, lessening the non-financial resources these firms can provide to new ventures.

- Takeovers may make businesses larger and more bureaucratic, making corporate sponsorship decisions less timely. This is a critical factor for new ventures.

I might also mention that I have heard reports that venture capitalists are finding that foreign businesses and private American businesses frequently make more positive and timely corporate sponsorship decisions than U.S. public companies. To the extent takeovers make firms or parts of firms private, in part they may eventually benefit some new ventures.

Many of the issues are the same for established small businesses. Some years ago, prior to the current takeover wave, I saw a study indicating that in a single year about 30% of small businesses were approached by a larger firm asking about a purchase, and about 5% of the businesses actually changed hands. Historically these transactions have been a source of liquidity for small business owners and more importantly have helped the U.S. economy by accelerating the diffusion of new products and services as the larger firms with superior resources rapidly commercialize the business idea generated by the small acquired business.

To me it is clear, aside from antitrust issues or the excessive use of economic pressure, that a system that freely permits takeovers of smaller businesses by larger businesses is desirable. If the discussion is confined to large takeovers (say involving $500 million or more) I expect that the same factors described above with respect to new businesses apply to existing businesses -- in short, that large takeovers have damaged existing small businesses.

Again I thank the Senate Committee on Small Business for the opportunity to appear before you.

Senator BOSCHWITZ. Well, I agree.

We seem to have covered the waterfront here pretty well this morning. And fortunately, my staff hasn't gotten me a gavel, so that I can gavel here.

We thank you for coming. We thank you, also, Dr. Reynolds, and we hereby declare the hearing at a close.

[Whereupon, at 11:45 a.m., the hearing was adjourned.]

APPENDIX

NATIONAL LUMBER AND BUILDING MATERIAL DEALERS ASSOCIATION NLBMDA

June 26, 1989

The Honorable Dale Bumpers
Chairman, Committee on Small Business
428A Russell Senate Office Building
United States Senate
Washington, D.C. 20510

Dear Senator Bumpers:

On behalf of our 10,000 corporate members, the National Lumber and Building Material Dealers Association requests that our views on OSHA's implementation of the Hazard Communication Standard be incorporated into the Committee's hearing record.

The National Lumber and Building Material Dealers Association (NLBMDA) is a federated trade association comprised of independent, family-owned and -operated retailers of lumber and building materials. Our average member has annual gross sales of $3.5 million and employs 22 part-time and full-time workers. NLBMDA's members supply approximately 70 percent of the lumber and building materials used in residential construction, and are therefore, in daily contact with professional building contractors and do-it-yourselfers. Being retailers, they have extensive responsibilities under HazCom.

NLBMDA's members are committed to the objectives of the Hazard Communication Standard (HazCom), but have strong concerns with OSHA's implementation of the program. While retailers have primary responsibility for educating and training their employees under HazCom, they are also responsible for providing, upon request, Material Safety Data Sheets (MSDS) to their commercial customers. As our members primary customers are contractors, their paperwork burden on hundreds of products considered "hazardous" under HazCom is substantial. While our members experience with HazCom is limited to date, some initial observations can be made.

If the fundamental purpose of HazCom is the communication of information regarding the "hazards" associated with chemicals and proper techniques for their safe handling, use, and disposal, then the program must be evaluated on its effectiveness in meeting these objectives. As the Committee is aware, the application of HazCom to the retailing community is essentially the same as that which applies to manufacturers and suppliers of chemicals. The "heart" of the current HazCom regulations is the MSDS. As such, the MSDS is designed to address essentially everything that is known about a chemical. Storing, copying and distributing hundreds of multi-page MSDS to commercial customers is creating an enormous paperwork and monetary burden for retailers.

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If one operates on the reasonable assumption that most employers and their employees in the retailing community haven't the technical knowledge to adequately decipher the contents of an MSDS, then the value of the MSDS as the principal communication tool is suspect. The most relevant portions of an MSDS -- as its relates to HazCom's principal objectives -- are the sections relating to special precautions (hazard information) and procedures on the safe handling, use, and disposal of products considered "hazardous chemicals." Most of the remaining information is more meaningful to an industrial hygienist or a medical professional in the event of a medical emergency.

In lieu of the MSDS, more emphasis should be placed on improved product labeling. Labeling which would provide appropriate warnings to employees about potential hazards associated with a given product and to provide a link (by toll-free telephone, FAX, or computer modem to the manufacturer or supplier, or to a OSHA-managed MSDS database) for acquiring additional information on the product -- such as an MSDS -- if circumstances dictate. Better labeling would more effectively promote the safe handling, use, and disposal of products considered "hazardous," and would assist employers in educating and training their employees about potential hazards in the workplace.

As a complement to improved product labeling and as an alternative to an MSDS, a concise, understandable "worker information sheet" outlining the potential hazard(s) associated with a given "chemical," its safe handling, use and disposal would be desirable. Such an approach is used by the wood industry in communicating "hazard" information on pressure-treated wood products. Pursuant to a 1984 EPA/Wood Industry agreement, the wood industry has utilized EPA-approved "consumer information sheets" as the principal communication vehicle on the safe handling, use, and disposal of pressure-treated wood products. A copy of a "consumer information sheet" for inorganic arsenical pressure-treated wood is attached for the Committee's consideration (Exhibit A). Such an approach, in our view, would more effectively target the audience -- the worker.

Fundamental to how burdensome HazCom is to nonmanufacturers is what products are defined as "hazardous chemicals." OSHA has adopted an approach that effectively requires all chemicals to be considered "hazardous" if there is any potential for exposure to the chemical, irrespective of the actual risk exposure to the chemical may entail. The lack of a significant threshold (or <u>de minimus</u>) for determining what chemicals are subject to the HazCom requirements has forced manufacturers and suppliers to err on the side of caution and provide an MSDS on products with minimal or trivial potential for chemical exposures. This further complicates the ability of retailers to train their workers about chemical exposures and health risks that are truly significant.

Related to what is considered a "hazardous chemical," is the lack of a meaningful exemption for a so-called "consumer product." OSHA's decision not to adopt the EPA Superfund definition of "consumer product" has unnecessarily expanded the number of products that manufacturers and suppliers must provide MSDS on. The Superfund definition focuses on the form and concentration of products packaged for use by the general public, relying on labeling of the product in conformance with relevant safety statutes and regulations to provide appropriate safe handling, use, and disposal information. The current HazCom "consumer product" exemption is of dubious value because of the difficulty retailers will have in convincing an OSHA inspector that a given "consumer product" is being used by their workers in the same manner as a typical consumer.

Employers are also required to maintain a copy of each MSDS or a list of "hazardous chemicals" used or present in the workplace for 30 years. So the broader the definition of products required to be labeled "hazardous chemicals," the greater the paperwork burden on employers. In addition, the "hazardous chemicals" of HazCom serve as the basis for reporting obligations under federal and state community right-to-know laws.

In large measure, the burden on the retailing community is driven by the requirements facing manufacturers and suppliers of "hazardous chemicals." We would submit that when OSHA extended application of HazCom to the nonmanufacturing section it performed insufficient evaluation as to whether the HazCom regulatory scheme developed for the manufacturing sector was indeed relevant to nonmanufacturers. We believe OSHA has sufficient regulatory discretion to refocus the application of HazCom as it applies to the nonmanufacturing sector.

Because of the litigation that has and still surrounds HazCom, it may be necessary for the Congress to address fundamental flaws in OSHA's implementation of HazCom to provide the necessary guidance to revamp the Standard. Further, it is essential that other federal agencies, such as the Office of Management and Budget and the Small Business Administration, retain regulatory authority and oversight in the area of information collection, to assure that the paperwork burden being imposed on the business community is minimized.

Along with our comments we are submitting a copy of the compliance manual (Exhibit B) we have made available to our members to help them comply with Hazcom.

Sincerely,

Harlan Hummel
Executive Vice President

Consumer Information Sheet

Exhibit A

INORGANIC ARSENICAL PRESSURE-TREATED WOOD

(Including: CCA, ACA, and ACZA)

CONSUMER INFORMATION

This wood has been preserved by pressure-treatment with an EPA-registered pesticide containing inorganic arsenic to protect it from insect attack and decay. Wood treated with inorganic arsenic should be used only where such protection is important.

Inorganic arsenic penetrates deeply into and remains in the pressure-treated wood for a long time. Exposure to inorganic arsenic may present certain hazards. Therefore, the following precautions should be taken both when handling the treated wood and in determining where to use or dispose of the treated wood.

USE SITE PRECAUTIONS

Wood pressure-treated with waterborne arsenical preservatives may be used inside residences as long as all sawdust and construction debris are cleaned up and disposed of after construction.

Do not use treated wood under circumstances where the preservative may become a component of food or animal feed. Examples of such sites would be structures or containers for storing silage or food.

Do not use treated wood for cutting boards or countertops.

Only treated wood that is visibly clean and free of surface residue should be used for patios, decks and walkways.

Do not use treated wood for construction of those portions of beehives which may come into contact with the honey.

Treated wood should not be used where it may come into direct or indirect contact with public drinking water, except for uses involving incidental contact such as docks and bridges.

HANDLING PRECAUTIONS

Dispose of treated wood by ordinary trash collection or burial. Treated wood should not be burned in open fires or in stoves, fireplaces, or residential boilers because toxic chemicals may be produced as part of the smoke and ashes. Treated wood from commercial or industrial use (e.g., construction sites) may be burned only in commercial or industrial incinerators or boilers in accordance with state and Federal regulations.

Avoid frequent or prolonged inhalation of sawdust from treated wood. When sawing and machining treated wood, wear a dust mask. Whenever possible, these operations should be performed outdoors to avoid indoor accumulations of airborne sawdust from treated wood.

When power-sawing and machining, wear goggles to protect eyes from flying particles.

After working with the wood, and before eating, drinking, and use of tobacco products, wash exposed areas thoroughly.

If preservatives or sawdust accumulate on clothes, launder before reuse. Wash work clothes separately from other household clothing.

Approved by the U.S. Environmental Protection Agency

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